

**THE HIGH COURT  
RECORD NO. 2011 NO. 219MCA**

**IN THE MATTER OF CUSTOM HOUSE CAPITAL LIMITED**

**FINAL REPORT TO THE HIGH COURT  
BY COURT APPOINTED INSPECTORS**

**19 OCTOBER 2011**

**VERSION FOR PUBLICATION  
(CLIENT NAMES AND ACCOUNT NUMBERS REDACTED)**

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## **PART A: INTRODUCTION/EXECUTIVE SUMMARY**

### **1. BACKGROUND**

#### **1.1 Description of Firm**

Custom House Capital Limited ('CHC') is authorised under Regulation 11 of the European Communities (Markets in Financial Instruments) Regulations 2007 ("**the MiFID Regulations**"). CHC was authorised under the Investment Intermediaries Act 1995 ("**the IIA**") since 15 January 1998 before its authorisation was transferred to MiFID on 1 November 2007. CHC's core activities relate to 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**").

CHC operates an exempt unit trust structure. An exempt unit trust is a collective investment scheme which is exempt from tax on its income and gains. The trust deed for each trust limits investment to investors who have an approved Revenue status such as a pension fund or charity. Exempt unit trusts do not fall within the scope of the Unit Trusts Act 1990 as they are not considered to provide facilities for participation by the public and are therefore not subject to authorisation or supervision by the Central Bank of Ireland ('Central Bank').

CHC acts as promoter and investment manager to CHC Investment Property Funds plc (CHC Property) which was authorised by the Central Bank on 25 September 2006 as a qualifying investor designated investment company under Part XIII of the Companies Act 1990. A qualifying investor fund is a non-UCITS collective investment scheme which targets institutional investors and high net worth individuals, with a minimum investment of €250,000.

CHC has approximately 1,500 clients, the majority of whom reside in the State.

#### **1.2 Hearing before the High Court on 15 July 2011**

The Central Bank made an *ex parte* application to the High Court on 15 July 2011 pursuant to Regulation 166 of the MiFID Regulations 2007 arising out of serious concerns it had about the affairs of CHC. The following orders were made by the Court:

- (i) An order pursuant to Regulation 166(1) of the MiFID Regulations 2007, authorising an investigation into the affairs of CHC; and

- (ii) An order pursuant to Regulation 166(2) of the European Communities MiFID Regulations 2007 appointing Noel Thompson and George Treacy of the Central Bank as Inspectors to:
  - (a) Investigate the affairs of CHC, and
  - (b) To report the results of the investigation in such a manner as the Court directs.

### **1.3 Hearing before the High Court on 20 July 2011**

In view of the *ex parte* nature of the application on 15 July 2011 the Court set a return date for 20 July to allow CHC the opportunity to object to the appointment and directed that an interim report be prepared for that date.

On 20 July the Inspectors' First Interim Report was produced to the Court. On that date CHC was represented in Court by counsel who indicated that CHC consented to the appointment of the Inspectors and wished to co-operate with the investigation. Counsel for CHC indicated to the Court that its acceptance of the appointment of the Inspectors should not be taken as acceptance of all of the matters that were averred to in the affidavit of Noel Thompson on behalf of the Central Bank grounding the *ex parte* application on 15 July 2011 to appoint Inspectors.

At the hearing on 20 July 2011 the Court made orders confirming its orders of 15 July 2011 in relation to the authorisation of the investigation and the appointment of Inspectors and directed that the Inspectors were free to tender a second interim report to the Court on 29 July 2011.

### **1.4 Hearing before the High Court on 29 July 2011**

On 29 July the Second Interim Report was produced to the Court. The Second Interim Report updated and expanded on the First Interim Report of the Inspectors and brought to the attention of the Court material matters which were identified in the intervening period. The Second Interim Report set out the Inspectors' understanding of the main issues based on:

- (i) the sworn evidence provided by witnesses who were required to attend before the Inspectors;
- (ii) the forensic work undertaken by KPMG who were retained to provide forensic, accounting and IT advice to the Inspectors;

- (iii) various meetings and correspondence with other firms and agencies including the Pensions Board, Appian Asset Management Limited ('Appian'), CHC and Horwath Bastow Charleton.

Upon reading the Second Interim Report the Court made an order that the Inspectors were free to tender a further interim report to the Court on 6 September 2011.

### **1.5 Hearings before the High Court on 6 and 16 September 2011**

On 6 September 2011 the Third Interim Report was produced to the Court. This was a short report intended only to give a brief update to the Court on the progress of the investigation. It did not contain any substantive information relating to the details of the investigation. A number of clients of CHC attended Court on this date. Counsel for 64 clients (represented by Lavelle Coleman solicitors) and counsel for CLIENT 1, a client of CHC, appeared and made an application to be made notice parties and to be provided with copies of the interim reports. The Court gave them liberty to bring motions grounded on affidavit in relation to these applications but ultimately no such motions were issued.

At this hearing on 6 September 2011 and a subsequent hearing on 16 September the Court gave directions in relation to the provision of extracts of the draft final report to persons in respect of whom findings were proposed to be made in the final report and a time period for those persons to make representations to the Inspectors. The Court also directed that the Inspectors' final report be provided to the Court under seal by 19 October 2011 and that the matter be adjourned for hearing to 21 October 2011.

### **1.6 Work completed to date**

As reported in the Interim Reports the Inspectors engaged KPMG to assist them in the investigation into the affairs of CHC.

The Inspectors engaged the services of McCann FitzGerald solicitors to provide on-going legal advice.

The Inspectors required the attendance of 18 witnesses for examination on oath ('Examination') before the Inspectors, 17 of whom attended and three of whom attended on two separate occasions. In calling the witnesses referred to above the Inspectors exercised their powers of compulsion under Regulation 169(2) of the MiFID Regulations. The witnesses are primarily current and former officers and employees of CHC. The Examinations were conducted by the Inspectors assisted on occasion by Mr Kevin Monks, an Authorised Officer

of the Central Bank. Each Examination was conducted orally with a stenographer present, with one exception where the witness provided a sworn written statement. A voluntary statement made by Mr John Whyte and supplied by his solicitor was also considered by the Inspectors, as appears below in the Report. Copies of the signed transcripts of the Examinations and of Mr Whyte's voluntary statement and the sworn statement by another witness are appended to this report and extracts from the transcripts of some of these Examinations and those statements are included in sections B and C below.

One Examination, that of Ms Michelle Donnelly, who worked in the Finance and IT departments in CHC, did not proceed as requested, because the Inspectors received correspondence from Ms Donnelly's solicitors enclosing medical certificates stating that Ms. Donnelly was unwell and not fit to attend the Inspectors for the Examination. While the Inspectors believed that Ms Donnelly was very likely to have information which has a direct bearing on the investigation, in the circumstances the Examination did not proceed. Please also see section C20 below which provides full details relating to this matter.

## **1.7 Internal Organisation of CHC**

As of July 2011, CHC had 4 directors, Harry Cassidy (who resigned on 13 July 2011), John Whyte, John Mulholland and John Anthony (Sean) O'Dwyer. Mr Cassidy and Mr Whyte were executive directors. Mr Mulholland and Mr O'Dwyer were non-executive directors.

The Inspectors wish to acknowledge the assistance that they derived from Mr Maurice Harte and Mr Sean O'Dwyer in the course of their investigation. Mr Harte was employed on a 1-year part-time consultancy contract to chair a property committee. He commenced in that role in March 2011. Mr O'Dwyer was appointed as a non-executive director of CHC in July 2009 at the request, and with the agreement, of the Central Bank. He became Chairman in late 2010. However, Mr O'Dwyer suffered a serious illness in early 2011 which hampered his ability to carry out his role. The Inspectors are satisfied that without the assistance and co-operation of Mr O'Dwyer, the investigation would have been considerably more difficult and protracted.

Mr Cassidy was the Chief Executive Officer. The Inspectors understand that his annual salary from CHC prior to his resignation amounted to €430,000. Mr Whyte's annual salary is understood to be €133,000 per annum.

CHC organises its staff in different units, reporting to the board of directors as follows:

1. Client Services – This section within CHC deals with all client queries, meetings with clients and reporting (including the issue of statements) to clients.
2. Finance and IT – This section within CHC deals with all payments and receipts regarding client holdings and CHC’s financial books and records. IT has responsibility for certain aspects of IT within CHC.
3. Property Fund Administration and Operations – This section within CHC deals with UK and Irish client property investments and other back office activities.
4. Compliance – This section within CHC is responsible for all compliance matters and for reporting to the Central Bank.

## **1.8 Examinations arranged and conducted**

The following Examinations were conducted by the Inspectors:

- (i) Liam O’Reilly - Property Fund Administration - 3pm on Monday 18 July
- (ii) Graham O’Reilly - Property Fund Administration - 4.30pm on Monday 18 July
- (iii) Finn O’Connell - Head of Operations - 6.30pm on Monday 18 July
- (iv) Paul Lavery - Head of Finance - 10.30am on Tuesday 19 July
- (v) Paul Lavery – Head of Finance - 11.00am on Friday 26 August
- (vi) Harry Cassidy – Former Chairman and Chief Executive Officer - 3pm on Tuesday 19 July
- (vii) Harry Cassidy – Former Chairman and Chief Executive Officer - 11.00am on Friday 2 September
- (viii) Ciara Kelleher – Senior Portfolio Manager - 10am on Friday 22 July
- (ix) Aleksandra Szelong – Client Reporting - 12 noon on Friday 22 July
- (x) Susan Fennell – Client Services – 2pm on Friday 22 July
- (xi) John Mulholland – Non-Executive Director - 2pm on Monday 25 July
- (xii) John Mulholland – Non-Executive Director - 4.30pm on Friday 26 August



- (xiii) John Whyte – Executive Director, Investment & Head of Private Clients - 2pm on Monday 25 July
- (xiv) Lesley Coulter – Compliance - 2pm on Tuesday 26 July
- (xv) Neil Bowes – Business Development - 4pm on Tuesday 26 July
- (xvi) Brian Cahalin – Compliance in Appian - 12.30pm on Thursday 4 August
- (xvii) Suzanna Cummins – Former Compliance - 2pm on Monday 8 August
- (xviii) Sean O’Dwyer – Non-Executive Director and Chairman - 4pm on Monday 4 August
- (xix) Maurice Harte – Chairman of Property Committee - 2pm on Thursday 11 August
- (xx) Natalie Burns – PA to Harry Cassidy - 4pm on Thursday 11 August

## **1.9 Summary**

The Inspectors have found that there was a practice of CHC effecting transactions on behalf of clients in a manner which could not have been envisaged by those clients and for which no mandate or authorisation had been given by such clients to CHC. In many cases these transactions were not only unauthorised but also improper.

These matters are described in more detail in the sections of this Report on specific issues and in particular the sections relating to the Destiny Cash and Destiny Equity Funds, Destiny Pooled Bank Accounts, Segregated Client Asset Accounts, Capital Protected Commodity Bonds, Stockbroker Capital Account and Luxembourg Account. A section in the Report (B7) outlines the current position on the Mezzanine Bond Fund issue, as stated at the time of the application to Court for the appointment of Inspectors, as being that €10.4 m (exclusive of interest) is owing to investors.

The Examinations under oath of individuals mentioned above together with information obtained from CHC’s offices (including records and e-mails) have confirmed that the concerns as set out in the affidavit grounding the application to appoint Inspectors and as initially outlined in a letter from Appian Asset Management Limited to CHC dated 8 July 2011 were well founded. However, the scale of the misuse of client holdings is now even higher than the estimated amount contained in the second interim report of €48.5 million since additional issues have been identified.

During the course of the investigation, the Inspectors have identified approximately €56 million of client holdings that were improperly transferred, with the majority of this money representing transfers to syndicated property investments. The improperly transferred client holdings were taken from various investment structures managed by CHC as follows:

	Total €m
• Destiny Cash Funds	13.60
• Destiny Equity Funds	16.87
• Destiny Pooled Bank Accounts	6.42
• Segregated Client Asset Accounts	11.90
• Capital Protected Commodity Bonds	<u>7.36</u>
	56.15

The Inspectors have completed the work of the investigation notwithstanding the limited amount of time and resources available for this. Mindful of the requirement as referred to in Regulation 168 of the MiFID Regulations that an investigation to be carried out as efficiently and as effectively as is practical in the circumstances, the Inspectors determined at an early stage that a comprehensive review of all material and reconciliation of all items would not be possible within an acceptable timeframe for completing their report to the Court. The Inspectors have therefore sought to identify and quantify the major issues of concern with respect to CHC's handling of the investments of its clients and the financial standing of CHC itself.

#### **1.10 KPMG Forensic Investigation**

KPMG were retained by the Inspectors to assist in the investigation. A report of the work conducted by KPMG since they were first retained is appended to this report.

#### **1.11 Proposal Submitted by Custom House Capital Limited**

CHC has been in discussion with a third party investment firm, duly authorised under the MiFID Regulations, to put in place an arrangement which would potentially offer a mechanism whereby there would be continuity in managing client holdings. That third party firm is Horwath Bastow Charleton ("**HBC**") and its associated company Horwath Bastow Charleton Wealth Management Limited ("**HBCWM**"). See Section D 21 of this report.

### **1.12 Pensions Board**

In relation to its pension services offering, CHC was granted approval from the Pensions Board to operate a number of non-standard PRSA products. On 15 July 2011 the Pensions Board issued a suspension on the approval of CHC's pension products. As a result, new contributions cannot be accepted nor can further contributions be made to CHC in respect of PRSA products.

### **1.13 Procedures adopted by the Inspectors in relation to the making of this final report.**

As outlined in Sections 1.6, 1.8 and 1.10 above the Inspectors carried out their investigation by the appointment of KPMG to carry out a forensic investigation and by conducting Examinations on oath of various individuals. KPMG's forensic investigation on behalf of the Inspectors involved retrieving, reviewing and analysing documents and correspondence of and relating to CHC. Based on the information and evidence gathered through these two processes, the Inspectors produced a draft of their final report.

The duty of the Inspectors is to investigate the affairs of CHC and to report the results of the investigation in such a manner as the Court directs. In conducting their work throughout the period of investigation commencing with their appointment on 15 July 2011, the Inspectors have been fully aware of the need to afford fair procedures. The Inspectors have also borne in mind the desirability of carrying out this investigation in as efficient and effective a manner as is practicable in the circumstances, and, having regard to the interests of clients of CHC, with a view to concluding the investigation and furnishing their report within a reasonable timeframe. The Inspectors were also conscious of the desire expressed by the Court that the investigation would be brought to finality with as much speed as possible consistent with fair procedures.

The procedures adopted by the Inspectors in carrying out the investigation ordered by the Court and in making their final report were necessarily constrained by the timeframe within which it was proposed and they were directed to complete their report. The Inspectors carried out a number of Examinations on oath for the purpose of obtaining relevant background information and some of this information is referred to by the Inspectors in this report. The Inspectors consider it important to record that the persons mentioned in the information gathered by the Inspectors have not been afforded all of the rights typical of an adversarial process, such as the right to cross examine witnesses. While the Inspectors do not consider that this is something which was required to have been done, whether by reason of fair procedures or otherwise, having regard to the nature and statutory context of this investigation, they wish to record that the information that has been gathered is subject to this

qualification and, as a result, it has not been possible in some instances for the Inspectors to resolve conflicts of evidence. Consequently the Inspectors have not made findings about individuals although they have recorded evidence which has been given about individuals and made statements of fact relating to individuals. It is important however that the limitations of the investigation process as outlined above are borne in mind when reading this Report.

When this matter was before the High Court on 6 September 2011, the Inspectors informed the Court that their final report was at an advanced stage and that they anticipated that certain findings may be expressed in the final report regarding certain individuals. The Inspectors also indicated to the Court that they had been advised and considered it appropriate that draft findings should be put to individuals in respect of whom such findings were proposed to be made. The Inspectors also indicated that if the Court was minded to prescribe time frames for the provision of extracts of the draft report to relevant persons this would be helpful.

On 6 September 2011, the High Court directed that draft findings should be furnished to the relevant individuals by Friday 16 September and that those persons would have 21 days to respond (i.e. not later than on 7 October). The Court also directed the Inspectors to produce the final report to the Court under seal on 19 October 2011. On the application of the Inspectors an order was made by the High Court on 16 September 2011 varying the order of 6 September 2011. The effect of the variation was that draft findings were to be furnished by the Inspectors to relevant individuals by 20 September 2011, and the 21 day period for individuals to respond was maintained with the result that any responses were directed to be given by 11 October 2011 although the date for the Inspectors to produce their final report was not varied.

The Inspectors sent extracts of the draft final report together with relevant exhibits to the report (comprising documents obtained by the Inspectors and/or KPMG during the investigation) to relevant persons, including CHC, on 20 September 2011 in accordance with the directions of the High Court. The Inspectors received representations from all of the persons to whom extracts of the final report were sent. The Inspectors reviewed all of the representations they received as a result of the process described above and had due regard to those representations in producing this final report. Certain legitimate concerns were raised in the said representations and a number of the proposed findings were amended or omitted having regard to the representations received with a view to the completion of the report within the mandated timeframe for so doing. The Inspectors wrote on 14 October 2011 to each of the parties from whom representations were received acknowledging receipt

of such representations, and advising that the representations were being considered and that the Inspectors would have due regard to them when finalising the report, and also replied in detail to those parties on 18 and 19 October 2011.

## **PART B: MAIN AREAS OF CONCERN**

### **2. DESTINY CASH FUNDS**

#### **2.1 Introduction**

The Destiny Exempt Unit Trust structure (“Destiny”) is set up as an exempt unit trust umbrella structure. Various sub-trusts were established as vehicles for client investments, including the Destiny Cash Funds, Destiny Equity Funds and sub-trusts for property investments as described in section B4.

There are two Cash Funds operating within the Destiny Exempt Unit Trust structure. The purpose of such funds, as is indicated by their names, is to invest in cash deposits or other liquid funds. The two funds described in this chapter were established to invest in gross paying deposit accounts with the objective of matching ECB interest rates. The purpose and intended manner of operation of such funds is clear.

The latest net asset valuation dated 14 July 2011 for one of these cash funds, the Destiny PRSA Cash Fund, states that it has €10,412,139 in assets being held on behalf of 485 clients. However, it appears that €9,930,999 of this, representing over 95% of the fund, was also transferred or in some fashion made available to CHC-promoted client property investments. The relevant transactions regarding this fund appear to date from 2008 through to December 2010.

The latest net asset valuation dated 15 July 2011 for the other cash fund, Destiny Select II Cash Fund states that it has €3,860,836 in assets being held on behalf of 58 clients. However, it appears that from this a balance of €3,674,803 (representing over 95% of the fund) had been transferred or in some fashion made available to CHC-promoted client property investments. The relevant transactions regarding this fund appear to have occurred between October 2010 and February 2011.

It therefore appears that €13.6 million was improperly taken from the two Destiny Cash funds to invest in or support CHC-promoted client property investments. The value and recoverability of the amounts thus transferred to support such investments cannot be readily determined.

The inspectors requested that KPMG specifically review a sample of individual holdings within these funds and a summary of their analysis is at section 2.3 below.

## 2.2 Sworn Testimony to Inspectors

In addition, the following statements, including questions where relevant, are taken from the voluntary statement of Mr John Whyte or transcripts of Examinations on oath:

### Mr Harry Cassidy on 19 July 2011

- Q. *Just to back up there, I am still confused. Of the two cash funds, the PRSA cash fund and the simple cash fund, they were not actually in cash?* [20:21-20:24]
- A. *Well, originally they were, yes.* [20:25]
- Q. *But, now, they are...* [20:26]
- A. *They are not now, they are holding equity in the SPVs.* [20:27]
- Q. *And what do you think of how that ties in with the mandate for the...* [20:28-20:29]
- A. *Well, again, it's not what you expect on a cash fund.* [21:01]
- Q. *Yes?* [21:02]
- A. *It's very definitely not. I think, from our point of view, there was a hope and an expectation that we would get ahead of the market and we would get the property sold. But that hasn't happened.* [21:03-21:06]
- Q. *In relation to the transfers from the cash fund, would you similarly have given that instruction?* [21:07-21:08]
- A. *No, I think I just said there a few minutes ago that I wouldn't have needed to give an instruction on that because it would have been cash. It may well have been -- you know, I may have given it verbally, I can't remember, but I am sure Paul or John wouldn't have done it without reference back to me. So I would have to accept that that would have been -- but I do not recall specifically writing an instruction. I do recall on the Destiny equity because we had to check the mandate on the Destiny equity, the Investment Management Agreement.* [21:09-21:19]

### Further on in the evidence of Mr. Harry Cassidy:

- Q. *Sorry, can I just go back one question before you get into that? You say that you don't recall giving an instruction for the cash funds. If you hadn't given an instruction, who else had the ability to give an instruction?* [21:26-22:02]
- A. *Well, I don't think it was absolutely necessary that there was a necessity for one. You know, I am not saying he did -- Paul or John could have made that transfer without my decision because it wouldn't be something that would have to be signed off. The only thing I signed off was if Paul -- you will see it one-mails -- sent me an e-mail saying he has to make a payment to, I don't know, whatever, to SPV, X, Y, Z, 'Can that be authorised?' and I would give a yea or nay check, you know, 'What's the payment for?', was it for a tax payment or whatever. So that could have happened. All I can say is very definitely I did give the instructions on the two equity funds because it was a change away from the quoted equities to equity in SPVs.* [22:03-22:17]

### Mr John Whyte on 25 July 2011

Q. *Can I just stop you there and just, perhaps if I paraphrase it, you can correct me if I am wrong, to make sure my understanding is correct? So from about 2007 onwards shortfalls in property transactions may have been remedied through access to individual client or the PRSA cash fund? [6:11-6:16]*

A. *PRSA cash, correct. [6:17]*

**Further on in the evidence of Mr. John Whyte**

Q. *I am not expecting you to have the specifics on it but for the earlier ones, the client level and the PRSA cash fund, so what amounts were we talking prior to quarter four 2010? [6:23-6:26]*

A. *On the PRSA cash fund you could have been looking at a figure between 10 and 11 million. [6:27-6:28]*

**Further on in the evidence of Mr. John Whyte**

A. *Like the bottom line the clients believed they were in a cash fund and to me I think it is as clear as day. You may have other people who may counter argue that but my view is a cash fund is a cash fund. [10:18-10:21]*

**Signed statement of John Whyte dated 17 July 2011**

PRSA Cash Funds – paragraphs 31 to 33

31. Another issue arises is in relation to the PRSA cash funds. Over a period of four to five years, on instructions from Harry Cassidy, money was transferred from those accounts into property investments.

32. I cannot specifically tell which accounts they went into but, again, I understand there is a complete money trail as to where those monies were actually allocated within the various property SPVs.

33. Again, I would have on repeated occasions tried to challenge Harry Cassidy verbally to return these monies to the PRSA cash funds and again I was told that properties were in the process of being sold and that monies would be returned. To date this has not happened.

**Mr Liam O'Reilly on 18 July 2011**

A. *There was a transfer that needed to be done for a client who had something like 300,000 in the pooled account that he couldn't get out. [43:09-43:11]*

Q. *Who was the client? Do you remember? [43:12]*

A. *Can I come back to you on that? [43:13]*

Q. *That's fine. But about 300,000? [43:14]*

A. *Yeah. And I was dealing with Finn. Finn would be aware of this as well, because we are dealing with Finn and I brought it up. We just couldn't. Money was -- we were not getting answers. So myself and Graham were basically having to deal with the client's broker, and got him the money. He wanted the money, and the money wasn't there. So I had a big row, eventually. I just blew my cool completely with the financial controller. [43:15-43:22]*



- Q. *Who is that?* [43:23]
- A. *Paul Lavery. Now, in Paul's -- in fairness to Paul, I mean Paul had to go to Harry. Like, we were lucky, myself and Graham. Like we could go to Paul a lot if we had an issue, but it was Paul had to deal with Harry, you know, so Paul was stuck in the middle sometimes, of the whole thing.* [43:24-43:29]
- Q. *Was that resolved?* [44:01]
- A. *It was. They sorted it out. They got the payment arranged from somewhere. It subsequently looks like -- well, I mean I did a review this week and it looks like it went from PRSA, one of the PRSA cash funds.* [44:02-44:05]
- Q. *It came from PRSA?* [44:06]
- A. *One of those PRSA funds, yeah.* [44:07]
- Q. *Would you know which one?* [44:08]
- A. *I know there was e-mails on those as well. There was e-mails on the timing because I looked at figures and confirmed the figures were correct, but we were always told to especially mandate. We were allowed to do it. And that Michelle, Paul and Harry, would agree the transfer between --* [44:09-44:14]
- Q. *Is that where it should have come is PRSA?* [44:15-16]
- A. *It was one of the pooled accounts. One of the Destiny accounts. There was no money in it, basically.* [44:14-44:18]
- Q. *You would be able to highlight if it was late or whatever?* [44:19-44:20]
- A. *Yeah. I mean, I remember at the time the figures -- the figures I was happy with the figures, but the only place that they wanted cover from was PRSA cash. And they said it was -- they did it from that, from the mandate. It was booked as a creditor or debtor on the opposite fund, you know, so now you had a creditor in one fund and a debtor on the other. But this appears in the review that I did last week.* [44:21-44:28]

**Further on in the evidence of Mr. Liam O'Reilly**

- A. *It was Finn got involved as well to try -- he was kind of in the middle as well just to see if he could -- and again, unfortunately, Paul had to -- Paul was really in the middle on it. It was up to Harry to say the funds were going to come from here, the funds were going to come from there. Paul didn't know the answers. But our contact is Paul when it comes to...* [45:15-45:21]
- Q. *But of course, Paul is the financial controller.* [45:22-45:23]
- A. *Yeah. And then Paul would have probably talked to Harry about it.* [45:24-45:25]
- Q. *Yes.* [45:26]
- A. *So there was a few -- it has been a very stressful few months for me and my team because there is a lot of invoices that we can't pay. There is a lot of bank loans that we can't pay. We try to manage that as best as we can, and all the senior management are aware of that. We have made it clear along the whole lines, what is going on.* [45:27-46:04]

**Ms Aleksandra Szelong on 22 July 2011**

- Q. *Was it e-mail?*
- A. *No, it wasn't e-mail, it was personally. I would say it happened about two months ago or three. It is difficult to say. I would say a few months ago I raised the questions of liquidity in the PRSA cash fund. I think this is in the e-mail. [28:01-28:05]*
- Q. *Those concerns were?* [28:06]
- A. *The concern is why PRSA Cash has got a low liquidity if it's a cash fund, although it's reconciled, and I was told that it's fine, it's just debtors' investments, where investments were bringing .75% return and everything's under control. [28:07-28:11]*
- Q. *The debtors were bringing -- the debtors had an interest rate attached to them?* [28:12-28:13]
- A. *Yes. 75%. [28:14]*
- Q. *The debtors?* [28:15]
- A. *Yes, just like a banking deposit, the same interest. [28:16]*
- Q. *That's strange?* [28:17]
- A. *They called it "debtors", but it was as if this is a deposit making money. [28:18-28:19]*
- Q. *Was it made clear at any stage who the debtors were?* [28:20]
- A. *No. Well, there should be a record in the folder, in the reconciliation folder where the interest in reconciled. Not all debtors were identified, but some debtors were identified, like, Destiny 140. [28:21-28:24]*
- Q. *Destiny 140, yeah, okay?* [28:25]
- A. *And then some of them would not even have a title or a narrative to it. You just see the reconciliation. [28:26-28:27]*
- Q. *Just a debtor and an amount?* [28:28]
- A. *Yeah, look at the printouts, the hard copy, it should have it all printed. [28:29-29:01]*
- Q. *Right, okay?* [29:02]
- A. *So the information is there. [29:03]*
- Q. *But Destiny 140, do you know which particular trust that was or vehicle that was?* [29:04-29:05]
- A. *I think it's Los Calados, I'm am not sure. [29:06]*
- Q. *That's the Spanish property investment?* [29:07]

- A. *I think so, I don't know much about this.* [29:08]
- Q. *So the cash fund had effectively a debtor, a Destiny140, with an interest rate attached to it?* [29:09-29:10]
- A. *Yes.* [29:11]
- Q. *Okay?* [29:12]
- A. *That is how it was explained, yes.* [29:13]
- Q. *And that was in the same -- was that an e-mail exchange?* [29:14-29:15]
- A. *This was now probably years ago, so there wouldn't be an e-mail exchange. If there was any debtor since I start reconciling it, there would be an e-mail saying this is the amount that went through the bank, this is to be treated as a debtor with this interest rate attached to it. There should be an e-mail.* [29:16-29:21]

**Ms. Ciara Kelleher on 22 July 2011**

- Q. *Now, in the light of what you now know, was CLIENT 2's holding actually in Munich Parkstadt?* [19:20-19:21]
- A. *I honestly don't know, honest to God. From my point of view, I had recommended to CLIENT 2 to move his cash to get a better interest rate. I would recommend that to all the clients because our interest rate was so poor. Like, we are getting, let's say on the PRSA cash fund, 25 basis points below ECB, which was lower than the fee charged on the account. So, in effect, sitting in cash, you were losing money and that's not even taking into account inflation risk or anything like that. So I would recommend to anybody -- like, up to last week, I was telling clients to move their cash to Merrion. We were doing that from -- like, I have been doing that as long as I kind of know that the interest rate was so poor on the Bank of Ireland accounts with ourselves and that has always been an issue because we are not really cash managers, but if client has a large cash balance, they should be earning on it.* [19:22 to 20:09]

**Further on in the evidence of Ms. Ciara Kelleher**

- Q. *Were there any other categories of payments that you are aware that were delayed or that you couldn't get satisfactory explanations for what was going through or not going through, as the case may be?* [32:11-32:14]
- A. *Well, I think the most recent one that I mentioned earlier was one where the client had PRSA cash, but I don't think the PRSA cash fund had enough.* [32:15-32:17]

**Mr Paul Lavery on 19 July 2011**

- A. *Mainly in the last few weeks there in relation to guys moving out of PRSA and then they'd be coming looking for cash and the cash wasn't there.* [24:14-24:16]
- Q. *Where was the cash supposed to be?* [24:17-24:18]
- A. *Supposed to be in the fund, cash, you know.* [24:19]
- Q. *In one of the Destiny funds?* [24:20]

- A. Yeah, Destiny appears in cash, yes. That was a main cause of it that we got people transferred out to different entities. [24:21-24:23]
- Q. They were looking to take the money altogether... [24:24-24:26]
- A. Correct, or to transfer the pension to a new provider, Aviva or New Ireland or whatever the case may be. [24:27-24:28]
- Q. In those circumstances, Paul, what actually happened? Was it the case that the payment never went to the client? [24:29-25:02]
- A. Correct, a lot of the payments haven't -- there's probably a backlog of payments there. I was talking to Liam yesterday and it's about 10 or 15 payments that haven't been completed yet. There is nothing I can do about it. The guys were on chasing me about it and I am chasing Harry and saying 'These are the issues here, Harry, and you need to resolve them'. [25:03-25:09]
- Q. And is there no money to pay them? [25:10-25:11]
- A. Correct. [25:12]
- Q. How much is it at the moment? [25:13]
- A. At the top of my head, I wouldn't know. There is so many of them going through. I don't know what the figure could be. It could be a few hundred thousand<sup>1</sup>. I know two cases where it's probably about 114,000 between two individuals. [25:14-25:18]
- Q. Has there been delays in the past as well where there hasn't been enough money? [25:19-25:21]
- A. Not so much in the past. It was just more recent here because people had moved out and any cash (inaudible) gone effectively. [25:24]

### 2.3 Forensic Examination By KPMG

#### Summary of NAV - Destiny Cash Funds, as at 14/15 July 2011.

	Destiny Select II Cash 15 July 2011	Destiny PRSA Cash 14 July 2011
	€	€
Cash	120,368	6,197
Debtors	3,674,803	
Cash Savings		9,930,999
Creditors		(118,784)
Interest accrual	66,785	598,364

<sup>1</sup> Underlined text has been added to the verbatim transcript by the interviewee

Fee accrual	(1,119)	(4,637)
	3,860,836	10,412,139
No of clients	58	485

A review of the latest daily Net Asset Valuations was prepared by CHC staff in respect of each of the above funds and the cash balances on these funds total €126,565 and reconciles to bank statements. However, the funds have a variety of amounts classed as debtors or cash savings. The use of the term “cash savings” is misleading and the “cash savings” account of €9.9m on the Destiny PRSA Cash fund is effectively a debtor balance accounting for the payments out of the cash account.

#### Allocation of the Destiny Cash Funds’ cash

	Destiny Select II Cash	Destiny PRSA Cash
	€	€
Destiny Property Fund		
CHC Prime Property Fund 1	230,758	
Destiny Property Fund 140 (Los Collados)	339,877	3,345,765
CHC Allemanic Fund	174,342	
CHC Hanseatic Fund		305,025
CHC Le Colbert Fund		
CHC Munich Parkstadt Fund	2,846,750	2,533,947
CHC Holstein Retail Fund		39,515
CHC Schleswig Retail Fund		1,225,438
CHC Jardin D’Osaka		
CHC Schlewzig Fund		
CHC Mezzanine Bond Fund		22,076
Destiny Property 173		1,577,167
CHC Jutland Retail		71,525
CHC Prime Property Fund 2		20,000
CHC Stadweg Retail		790,540
CHC Grenoble Fund	63,500	
	3,655,227	9,930,998

The difference between €3,655,227 and €3,674,803 appears to be due to an interest accrual on the amounts advanced. The above analysis by KPMG indicates that cash was paid from the bank account of each of the Destiny Funds and used for purposes connected with CHC promoted property funds, or cash was used to repay other investors whose funds had been used to invest in property funds. CHC staff identified, based on the transfer documentation for each payment, the property fund to which each payment out of the Destiny Funds relates. However, the other side of this process, to look at each fund and identify what the funds were used for, is not complete.

For example:

- €63,500 has been allocated to CHC Grenoble Fund, but the cross holding report for this fund (a report that lists all investors) does not record any investment by Destiny Select II Cash [KPMG Exhibit 34]; and
- €3,685,642 has been allocated to Destiny Property 140 (Los Collados). However, no investment is recorded by either the Destiny Select II or Destiny PRSA Cash Funds in the cross holding report for the Destiny 140 Property.

#### Destiny Select II Cash - Summary of Debtors amounts

	Date of transaction	Amount €	CHC employees involved in relevant correspondence	Summary of payment - based on review of emails, Unity, and Therefore	Fund allocation
1.	17/12/2010	60,000	Harry Cassidy, Paul Lavery and John Whyte	CLIENT 3's funds were in the Marseille Bond, he sought funds back, paid from this account and debtor posted to QIF 1	QIF 1
2.	18/10/2010	63,500	Harry Cassidy, Paul Lavery and John Whyte	CLIENT 4's funds were in Grenoble and Parkstadt, he was not aware, he was informed funds in cash deposit. When funds sought by client, paid from this account and debtor posted to Grenoble and Parkstadt	Grenoble
3.	15/10/2010	170,758	Harry Cassidy, Paul Lavery and John Whyte	This relates to payment to Credit Foncier de France re PleinOuest	QIF 1

	Date of transaction	Amount €	CHC employees involved in relevant correspondence	Summary of payment - based on review of emails, Unity, and Therefore	Fund allocation
4.	12/10/2010	174,342	Harry Cassidy and Paul Lavery	CLIENT 5's funds were in Allemanic, he was informed funds in Select II Destiny PRSA Cash. When funds sought by client, paid from this account, and debtor posted to Allemanic	Allemanic
5.	28/09/2010	250,160	Harry Cassidy, Paul Lavery and John Whyte	CLIENT 6's funds were meant to be invested in this fund, but €250k had been invested in Allemanic and Munich Parkstadt. When funds sought by client, paid from this account, and debtor posted to Munich Parkstadt	Parkstadt
6.	16/02/2011	339,877	Harry Cassidy, Paul Lavery and John Whyte	CLIENT 7 was due a payment of €1m, not there, €339k paid from this account, and debtor posted to DP 140 (Los Collados)	DP 140
7.	22/09/2010	496,306	Paul Lavery and John Whyte	CLIENT 8's funds were stated to be in Select II Destiny PRSA Cash, but 400k had been invested in Grenoble and €100k in Munich Parkstadt. When client sought funds, paid from this account and debtor posted to Munich Parkstadt	Parkstadt
8.	18/10/2010	544,533	Harry Cassidy, Paul Lavery and John Whyte	CLIENT 4's funds were in Grenoble and Parkstadt, he was not aware, he was informed funds in cash deposit. When funds sought by client, paid from this account and debtor posted to Grenoble and Parkstadt	Parkstadt
9.	26/10/2010	1,555,750	Harry Cassidy, Paul Lavery and John Whyte	Approx €1.5m of CLIENT 9's funds were in Landsberg and Parkstadt, when funds sought by client, paid from this account and debtor posted to Parkstadt	Parkstadt
		3,655,227			

All of the above payments, with the exception of the payment to Credit Foncier de France, were payments to clients, where the funds were not available on those clients' accounts to make the required payments.

More detailed information supporting the payments of €63,500 and €554,553 (at numbers 2 and 8 above), allocated to CHC Grenoble and CHC Munich Parkstadt is provided below, with both payments relating to CLIENT 4.

- On 18 October 2010, €608,033.31 was transferred from the Destiny Select II Cash bank account to a Permanent TSB account. This was divided into two amounts on Unity, €63,500 and €544,533.31, with the reference CLIENT 4. This transfer was set up by Paul Lavery and approved by John Whyte. Harry Cassidy was copied on the email. [KPMG Exhibits 38 and 39]
- The valuation statement prepared for CLIENT 4 at 30 June 2010 indicates a holding of €36,500 in CHC Grenoble Fund, and €520,186.47 in Client Asset Gross Savings. [KPMG Exhibit 40]
- At 30 June 2010, CLIENT 4's balance in Client Asset Gross Savings nominal ledger was €7,564.47. His funds are recorded on this account as having been paid out to CHC Prime Property Fund 2 €362,222, CHC Grenoble Fund €100,000 and CHC Munich Parkstadt Fund €150,000. [KPMG Exhibit 41]
- It would appear that CLIENT 4 was aware of an investment of €36,500 in CHC Grenoble, but considered that the rest of his funds were held in cash, when this was not the case.
- The client requested that his cash investments be placed on deposit with Irish Life and Permanent. [KPMG Exhibit 42]
- In an email dated 21 October 2010 addressed or copied to 12 other members of staff of CHC including (among others) Paul Lavery, John Mulholland and John Whyte, Catherine Coleman states the following [KPMG Exhibit 43]:

*"Funds were transferred from Select II PRSA Cash to Irish Life & Permanent for the following:*

CLIENT 4 AMRF - €63,500

CLIENT 4 ARF - €544,533.31

*This money has been reflected on the PRSA Select II cash side by Johnny as a debtor, the understanding being that this money will be refunded back to Select II PRSA Cash middle of next week as per phone conversation with Paul.*



*To reflect the transfers to ILP Accounts on the clients ARF and AMRF on unity I have done the following:*

*CLIENT 4 AMRF – sold out of CHC Grenoble Fund for €63,500 through stockbroker and transfer to LLP Deposit A/c through stockbroker*

*CLIENT 4 AMRF – sold out of CHC Prime Property Fund II for €362,622, CHC Grenoble Fund for €36,500 and Munich Parkstadt fund for €145,411.31 all through stockbroker and transfer to LLP Deposit a/c through stockbroker.*

*Please be aware that this client has received no interest on his cash holdings as these were all reflected through property up to now. Client team please be aware of this for valuation purposes.*

**Ciara Kelleher responded to this email stating:**

*“Paul, this is going to cause a problem on the client reporting side.*

*a) Valuation will show investments and sales in investments the client did not authorize*

*b) We will need interest accrual on the cash (€600k+) from April/May 2009 to date as the valuation that went out in June 2010 is only showing residual interest postings of €4 and €5..*

*Can you review and revert.*

The valuation statement prepared for CLIENT 4 for 31 December 2010 records that the CHC Grenoble investment of €36,500 recorded on his earlier statement was sold on 18 October 2010, and the funds transferred to Irish Life and Permanent. [KPMG Exhibit 44]

In summary, the payment to CLIENT 4 from Destiny Select II PRSA Cash was a repayment of his funds, which he had been told had been placed on cash deposit but instead had been paid out and allocated to CHC Munich Parkstadt and CHC Prime Property Fund 2.

Outlined in the second table above is a listing of the various amounts making up the debtor balance of €9,930,999 in the Destiny PRSA Cash Fund. The majority of the amounts relate to payments made directly to Spanish, Luxembourg, German and British banks. The following payments were made in respect of repayment of client funds and other payments:

- €340,056.50 in relation to a payment to CLIENT 7 ; [KPMG Exhibit 47]
- €98,153.33 transferred to PTSB in relation to repayment to CLIENT 10 of his funds on 23 December 2010; [KPMG Exhibit 48]
- €20,000 paid to CLIENT 11 in relation to invoices for agreed commissions in relation to investment in a commodity bond and in Qualifying Investor Fund 2 SARL relating to clients introduced. This represents a commission amount due and payable by CHC that CLIENT 11 was demanding from Paul Lavery for 9 months; [KPMG Exhibit 49]

- €533,944.90 paid to CHC on 18 November 2008. This appears to relate to a payment made to Bank or Ireland regarding a CHC loan on 18 November 2008. This is noted as relating to Parkstadt; [KPMG Exhibit 50]
- €352,326 – paid to Destiny Client Savings on 30 March 2009 in respect of five investors’ initial investment. This is described as being invested in “Pan European Fund”. [KPMG Exhibit 51]
- €213,210.71 paid to Mezzanine Bond on 11 March 2009. This related to the initial investment of nine investors, and €191,134.54 was repaid on 31 January 2011. [KPMG Exhibit 52]

The following email was also identified by KPMG in their analysis

- An email dated 8 July 2011 from Harry Cassidy to Paul Lavery (Inspectors Exhibit 1)  
*“Paul..loans will not work.. it will look the same as mezz.. will have to be ranked against bank debt and equity and thus more regulatory problems.*  
*Suggest as follows PRSA Cash invests in to a destiny fund [number going back a while so not most recent number as investment happened a while ago] and that destiny fund invests as equity into each spv/ property fund by way of equity? So will need applications forms signed not loan notes.”*

## 2.4 Conclusions

It is clear from a review of the assets held in the Destiny Select II Cash Fund and the Destiny PRSA Cash Fund that the money within these funds was used to support various CHC client property investments. Money was also used for the purposes of meeting other requests from clients for the redemption of their investments. In one instance payment was made in respect of commission owing by CHC to an introducing broker for investment in other funds.

The Inspectors have concluded that both cash funds had ceased to operate in the manner for which they were established and could not meet the legitimate requests from clients for money to be repaid.

It is beyond question that the transfer of money from these cash funds to become loans in commercial property vehicles was contrary to the proper conduct of such funds and without justification.

### **3. DESTINY EQUITY FUNDS**

#### **3.1 Introduction**

There are a range of Equity Funds operating within the Destiny Exempt Unit Trust structure which typically would invest in global equities. The promotional material for these funds stated that they provide a reasonable balance between dividend yield and capital growth within a diversified portfolio investing in the major equity markets. As a matter of common sense, the Inspectors consider that funds of that designation would be understood and represented and expected to have such an investment objective.

The Destiny PRSA Equity Fund valuation dated 11 July 2011 states that it has assets with a net asset value of €8,918,591. It has a total of 154 unit-holders. However, a review of the assets held by this Fund suggests that €6,801,813 (in excess of 76% of the net asset value) appears to represent interests in a variety of CHC-promoted property related investments. The conversion of equity holdings to cash, which was then used to support property investments, appears to have occurred largely between October 2010 and March 2011.

The Destiny Equity Fund valuation dated 22 June 2011 states that the net asset value of the fund is €11,833,043. It has a total of 120 unit-holders. However, in this case €10,071,297 (or in excess of 85% of the net asset value) appears to represent interests in property related investments. The conversion of the equity assets to cash and subsequent use in connection with property investments appears to have occurred primarily between September 2010 and December 2010.

An unsigned, undated note purportedly reflecting the views of the trustee, M&F Finance (Ireland) Limited, and CHC to the effect that the objectives of the Equity funds permitted investment in property was initially produced by Appian, who stated that they were provided with it by Mr Cassidy.

Thus, it would appear that equity assets amounting to €16.9 million have been encashed and the proceeds improperly used to support a range of CHC-promoted property investments. In the absence of a thorough and up to date review of the valuations of the properties in connection with which such funds have been used, and (where relevant) the financial position of the special purpose vehicle companies owning those properties, the recoverability of the amounts thus used cannot be assessed.

The Inspectors requested that KPMG specifically review a sample of individual holdings within these funds and a summary of their analysis is contained in section 3.3.

### 3.2 Sworn Testimony to Inspectors

The witnesses called by the Inspectors were asked to describe the operation of the Destiny Equity Funds, comment on whether they were aware that assets were transferred to property investments and asked who authorised the transfers.

The following statements, including questions where relevant, are taken from the testimony, the sworn statement provided by Brian Cahalin and the voluntary written statement provided to the Inspectors by Mr John Whyte in this regard:

#### Mr Harry Cassidy on 19 July 2011

A. *I think just for me to clarify for you, the last -- George asked me when was the latest or the most recent transfers and I would have said May, April or May, those monies would have come from the Destiny equity fund, so not directly from a client portfolio. So, therefore, there wouldn't have been a transaction pack around that. So it would have been under the Investment Management Agreement of the investment managers to the unit trust that that money was transferred<sup>2</sup> the same as if they were buying an equity, there wouldn't as far as I am aware<sup>3</sup> be a transaction pack for the equity on the unit trust, so the transfer would have been made from that unit trust. So I wouldn't, off the top of my head, know when the last transaction specific to, say, a client was done. I just wouldn't have any idea when that was done, and I think that is probably a long time ago -- well, 18 months or so possibly. But the most recent would have come from the Destiny equity unit trust, so the Destiny equity... [17:10-17:28]*

Q. What size was that transaction?

A. *In amount terms?*

Q. Yes?

A. *...A couple of million because the unit trust is -- and, again, you can check this and my numbers might be wrong, but the unit trust is probably somewhere between 10 and 12 million, I think. So two or three different transactions would have amounted to 6 or 7 million. You got a copy of Appian's letter I presume, so you will have seen from Appian letter a reference to a figure of 50% of one unit trust. So that is where that would have arisen from. [18:04-18:12]*

Q. Would that have been in line with the investment? [18:13]

A. *That's a debatable point on the basis that the investment managers have permission to invest in equities or equity of companies, and the investments made by the unit trust was into the equity of the SPVs, so not specifically directly into the property. So it would have been regarded as covered by that. It's an argument that could go on all day as to whether there was more risk in that than holding it in equities, but you can have that argument about had the portfolio been Italian <sup>4</sup>bank shares, which would have been regarded as low risk five years ago, would have all been lost.*

Q. So, on balance, it is probably not the best thing to do.

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<sup>2</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>3</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>4</sup> Interviewee stated that he would have either said "Irish bank or Anglo Irish Bank as reference to poorly performing shares"

- A. *On balance, probably it's a higher risk and that's one of the issues Appian have. But, you know, there are many companies out there that you can invest in, CRH being one, and others whose portfolios when you look through them are very heavily property orientated anyway. So it's a debatable point. [18:14-19:02]*
- Q. *Would you have given that instruction to move that? [19:03]*
- A. *That would be my decision and I would have given that instruction. [19:04]*
- Q. *Right? [19:05]*
- A. *Yeah, I would have given that instruction in terms of the Destiny equity unit trust and the Destiny PRSA equity fund, very definitely. [19:06-19:09]*
- Q. *Of the total value of the Destiny equity and cash funds at this stage, how much of that would actually be in property? [19:10-19:12]*
- A. *Well, that's an exercise that Bastows are working on at the moment and I think the figure is somewhere around 20 million. I might be wrong, but it could be 22 or it is somewhere between 20 and 24 million. [19:13-19:16]*
- Q. *I had an indication that of a value of 32 million, 30 million was in property. Would that be surprising? [19:17-19:18]*
- A. *You had a value of? [19:19]*
- Q. *Of 30 million in property out of a total value of 32million? [19:20-19:21]*
- A. *From all the unit trusts. [19:22]*
- Q. *From the Destiny equity. [19:23]*
- Q. *Well, maybe if I just explain, as far as we are aware, there is two Destiny equity funds? [19:24-19:26]*
- A. *There is Destiny Equity and Destiny PRSA Equity, and there's two cash funds, Destiny PRSA Cash and Destiny Cash, yeah, so they are the four funds. [19:27-19:29]*
- Q. *So I think the point that George was trying to make is that, in total, in aggregate total for all of those funds, potentially you are talking about 32 million, but 30 million of that total being invested somewhere in property vehicles or property related vehicles? [20:01-20:05]*
- A. *That sounds high to me. I think the -- certainly, as I said, I would have given the instruction personally and only me on the two equity funds. There wasn't a requirement, because I didn't give any instruction on the PRSA cash or the Destiny cash, so I would have to just think about that<sup>5</sup>. The two equity funds, the total is around 20 million or the total of the cash value of those two funds. I think, in one, there is 50% in property and the other is 80%. So, you know, using an average, it's probably 65%. So 65% of 20 million is about 14, 13 or 14, give or take. Then the PRSA cash, that's probably, I don't know, 90% in equities from what I understand. And I don't have the figures off the top of my head how much was in those. So your 30 million may well be right, I don't have that figure. [20:05-20:20]*

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<sup>5</sup> Mr Whyte and Mr Lavery have each observed to the Inspectors that they would have transferred funds from cash to property only on instructions from Mr Cassidy. Having regard to the considerations outlined at paragraph 1.13 above, the inspectors have been unable to form any conclusion on this.

**Mr. Harry Cassidy on 2 September 2011**

- Q. There is just one other issue here, Harry. A document again, unsigned and undated headed 'Investment Objective of the Destiny Equity Fund'. If you could just maybe have a look at it and clarify whether or not it is only ever a draft document or whether it did actually get signed? (Same handed) [47:02-47:08] [Inspectors' Exhibit 2]
- A. *My understanding that is more than draft, that was signed off by, I think, both -- certainly myself and, think, John Whyte as the investment director.* [47:09-47:11]
- Q. Yeah. I think it was on behalf of, was that you would be signing on behalf of? [47:12-47:14]
- A. *I would have signed on behalf of the trustees, M&F and John Whyte would have signed on behalf of Custom House Capital.* [47:15-47:17]
- Q. Right. Is there any chance that you might have a signed copy of that? [47:18-47:19]
- A. *Well, I won't have a hard copy of it. I can ask John Whyte if he will produce it, but what has happened recently nobody is talking to me, so the likelihood of me getting it is pretty slim, but certainly I do recall signing this and I do recall having a conversation with John Whyte about the amendment of our investment objectives around the fund.* [47:20-47:26]
- Q. Do you recall what time -was it recently? [47:27-47:28]
- A. *No, it wasn't recently. It could have been 12 months ago, 18 months ago. I don't have an exact time on the exact timing on that, but it was definitely signed.* [47:29-48:02]
- Q: Okay. [48:03]
- Q. You mentioned amending the objectives of the fund? [48:04-48:05]
- A. *Well this is amended to reflect the investment manager may also invest in private equity or SPVs.* [48:06-48:07]
- Q. Other than simply an opinion that that was available under the existing powers? [48:08-48:09]
- A. *Sorry I don't. (Document handed back to George Treacy) I think that, to answer your question, George, that document was drafted so that we would have the powers to invest in SPVs, where as previously the investment objectives would more likely only have been quoted equities in unrecognised stock exchanges.* [48:10-48:15]
- Q. Okay, because I have used this -- I had seen this and took it that it was an opinion being given on the existing investment objectives? [48:16-48:18]
- A. *No, no, no, I think it was an amendment to those powers that were already there.* [48:19-48:20]
- Q: Okay, Okay. [48:21]
- A. *That is my understanding of it anyway.* [48:22]

- Q: And when you say invest asset out in this document in private equity or SPVs, do you mean acquiring shares in the SPVs. [48:23-48:26]
- A. *Sorry, acquiring shares in the SPVs, as opposed to buying property itself, we wouldn't have, but we would have been an investor the same as you or I or someone else would have been an investor.* [48:27-49:01]
- Q. As holding shares? [49:02]
- A. *Yes.* [49:03]
- Q. And did that actually happen? [49:04]
- A. *Through the Destiny Equity Fund, yes it did, yes.* [49:05]
- Q. So the Destiny Equity Fund then, it holds shares in various SPVs? [49:06-49:07]
- A. *It would, yeah. That is where it would have come up in your inspection and both KPMG I am sure and certainly HBC, you will see that certain equities in Destiny equity funds would have been disposed of and monies invested in SPVs; the likes of Jutland and Holstein and others.* [49:08-49:13]
- Q. Again, just for clarity when you say invested? [49:14]
- A. *Well, buying shares in those SPVs, yes.* [49:15]
- Q. Directly. And those shares then would be registered in the name of the Destiny Equity Fund? [49:16-49:17]
- A. *Yes. So when that property was sold that money would be due back to the Destiny Equity Fund.* [49:18-49:19]

**Mr John Whyte on 25 July 2011**

- Q. Can I just stop you there and just, perhaps if I paraphrase it, you can correct me if I am wrong, to make sure my understanding is correct? So from about 2007 onwards shortfalls in property transactions may have been remedied through access to individual client or the PRSA cash fund? [6:11-6:16]
- A. *PRSA cash, correct.* [6:17]
- Q. Whereas from quarter four of 2010 they would have been. [6:18-6:19]
- A. *The equity fund.* [6:20]
- Q. ...the use of the equity funds? [6:21]
- A. *The Equity Unit Trust fund, correct.* [6:22]

**Further on in the evidence of Mr. John Whyte**

- Q. Okay. Then the additional amounts that we are talking about in relation to the unit trust equity was...? [7:23-7:24]

- A. *The unit trust, there are three equity funds, of which there were two equity funds utilised. The total figure in those, and again I stand to be corrected, but may be in the order of 16 to 17 million. [7:25-7:28]*
- Q. Right. [7:29]
- Q. Which one wasn't affected John? [8:02-8:03]
- A. *The Select II PRSA equity fund Noel. The two that were affected were the PRSA equity fund and the Destiny equity fund. [8:04-8:06]*
- Q. Is there any reason why the Select II PRSA wasn't affected? [8:07-8:08]
- A. *I don't know Noel. I think it was the Select II PRSA equity fund by volume is the smallest of the three funds, so I would suspect because of the size of the fund. [8:09-8:12]*
- Q. What value would that be at now or do you know? [8:13]
- A. *It is approximately about 2, 2.3 million Euro. [8:14]*

**Further on in the evidence of Mr. John Whyte**

- Q. What about the equity fund? [10:22]
- A. *The equity fund the same; it can be argued there is a discretionary mandate and the investment manager has control over the underlying assets, but again if you are an investor your view and belief is that you are in an equity fund. [10:22-10:27]*
- Q. Right. [10:28]
- A. *It could be argued again from a technical and legal point of view whether unit trust has all these powers to invest in SPVs or borrow, etc, etc but you have an equity fund. [10:29-11:03]*
- Q. Right? [11:04]
- A. *And it is represented as an equity fund, so anything different to me- [11:05-11:06]*
- Q. The SPVs when they were represented in the system that you have in CHC, there seems to be some confusion of whether they were represented as shares or bonds? [11:07-11:09]
- A. *Okay. On the, on the two specific equity funds, for example [11:10-11:11]*
- Q. Yes. [11:12]
- A. *They were represented as a Valovis bank bond because that is where the monies went into. [11:13-11:14]*
- Q. What is it called, sorry? [11:15]
- A. *Valovis, V-A-L-O-V-I-S. [11:16]*
- Q. Oh right, okay. [11:17]



- A. *That is the name of the receiving bank for the funds and that is how they were represented as security on the valuation report. [11:18-11:20]*
- Q. Right and they are in coupon? [11:21]
- A. *Well there was an indicative coupon given but effectively the monies were transferred over as a, as some form of cash back or against the strength of the property value. [11:22-11:25]*
- Q. Right, okay. Were there any, actually any bonds ever issued?  
Did the SPV actually issue any? [11:26-11:27]
- A. *No, I have not seen any certificates issued or any paperwork issued in terms of that. [11:28-11:29]*
- Q. Right. You mention, is there another one other than the Valovis bond? [12:01-12:02]
- A. *Again I don't know if this is reflected in the valuation, but part of the monies transferred were to Saarslandes Bank, S-A-A-R-S-L-A-N-D-E-S B-A-N-K. Now I don't know the breakdown off the top of my head, the breakdown between... [12:03-12:07]*
- ...
- A. *Valovis Bank or the Saarslandes Bank, but again they would be represented as some form of asset on the valuation. [12:09-12:11]*

**Further on in the evidence of Mr. John Whyte**

- Q. John is it your understanding that this money that has been moved to, whether it is Valovis or Saarslandes Bank is being held by those institutions, it hasn't actually gone into the SPVs themselves that are holding the properties? [13:02-13:07]
- A. *I don't know, Noel, because I have not actually physically, even though I have tried to see the physical bank statements to see, because I know the monies we transferred over and there was a receipt of payment, but I don't know if they are actually still sitting within the banks and are held as a back to back against the strength of the property or not, I don't know the answer. [13:08-13:15]*
- Q. Okay. [13:16]
- Q. Do you know if the bank has a claim over them or - [13:17-13:18]
- A. *I don't know that, George, to be absolutely honest with you. I would suspect if you got a bank statement from Valovis Bank and the money is sitting there then the answer would be yes, the bank obviously would have a lien over that. [13:18-13:23]*
- Q. Right. [13:24]
- A. *Because the money hasn't been used for an SPV in the German core property, etc. If the money has been moved then it has gone in through the SPV structure. So one way or the other it is linked to property but I cannot say if it is actually cashed back against a property or whether the bank have a lien. You would only know that by looking at the deposit account. [13:25-14:02]*
- Q. Right. [14:03]

- A. *But as I said, just to repeat, if the deposit was sitting within the Valvois Bank I am 99% sure that the bank have a lien over that. [14:04-14:06]*
- Q. Right. [14:07]
- A. *Against the strength of the property. [14:08]*

**Signed statement Mr. John Whyte on 17 July 2011**

22. In May 2000, CHC took over the investment management of a number of unregulated unit trusts from Guinness & Mahon Private Bank.
23. These unit trusts have sub-funds within their structures. By way of example, the sub-funds may include equity funds and cash funds. The unit trust may also be permitted to borrow within the unit trust structure.
24. CHC would have a discretionary mandate to manage the investment of the unit trusts, within the investment parameters set out for each sub-fund.
25. In two equity sub-funds, transactions were carried out on the instruction of Harry Cassidy in the fourth quarter of 2010 and in March 2011 where shares held by the sub-funds were sold to fund a property deal in Germany, which I believe was the German co-op property portfolio.
26. My authorisation was required to process these transactions. I challenged Harry Cassidy at the time saying I was not prepared to carry out these transactions. I was told by Mr Cassidy that he had no other option, as otherwise he would have lost the deposit on the property, the deal would have collapsed and he would have to notify the Central Bank.
27. I was in a very difficult position, boxed into a corner so to speak. On this basis, I proceeded on his instruction to sell the shares and the underlying assets were transferred over to Valvois Bank in Germany
28. These investments were reflected in the system as a Valvois Bank bond and again there would be a money trail from the monies going from the relevant equity fund into the individual SPVs through Valvois Bank.
29. It is important to note that CHC would have a discretionary mandate to manage the assets of these sub-funds. The unit trust documents have specific investment terms

and an investment mandate was also included in terms of the equity fund, setting out what it can and cannot invest in. The clients would not have discretion over these unit trusts.

30. All of these payments would ultimately have occurred on the instruction of Harry Cassidy and no authorisation and no transfer of funds would be carried out without his prior approval. This would be related to all payments he would have made in relation to the equity fund.

**Mr Maurice Harte on 11 August 2011**

Q. Yes. At any stage was there mention or discussion or reference to investments in the properties by the Destiny equity funds or the Destiny cash funds? [30:14-30:16]

A. *Not on the Property Committee at all.* [30:17]

Q. Right? [30:18]

A. *On no occasion. The first I was conscious of that was in the correspondence from Appian where at the emergency Board meeting on the Monday, the following Monday, the question was asked and confirmed that the accusation being made by Appian or the complaint made or the statement made was that 'correct or not' and it would appear that it was substantially correct and that was the first one that came up. We got further information when HBC did their initial investigation over the weekend and it came up with a preliminary assessment of the exposures there.* [30:19 to 30:29]

**Mr Sean O'Dwyer on 8 August 2011**

A. *I think I asked something about, well, how come Appian weren't aware of this because there was the point about the unit funds being in the properties, how come Appian weren't aware of that, and Harry made some comment about 'Oh, well, they didn't ask and I didn't tell them' and I kind of went 'Jesus' -- excuse me -- that's terrible, you know, just because somebody doesn't ask the right question in a way.....Then on Monday morning we had a Board meeting and Harry clarified a bit more, that, yes, this had happened, money had been taken from clients' accounts and the unit funds and invested in certain properties. I asked a few questions, you know, of when did that happen, you know, and there was some reference to it starting maybe four years ago for some of the funds, but also being as recent as March 2011. Well, now, whether that was at the Board meeting or subsequently, I don't know, but March 2011 was the latest one that was disclosed to me.* [6:25-7:27]

**Further on in the evidence of Mr. Sean O'Dwyer**

A. *It was just the Cash fund had first been used, say, four years ago. And the Equity fund, I think Harry had said that the Equity fund was probably primarily August and September of 2010, but then Harry or John -- I'm not sure -- somebody said March 2011, there had been a transaction as well in the Equity fund.* [11:22-11:27]

**Further on in the evidence of Mr. Sean O'Dwyer**

- Q. There was an undated, unsigned advice purporting to be from M & F Finance and CHC suggesting that investment in property related investments by the Equity, the Destiny Equity fund was permissible; would you have been familiar with that? [24:12-24:16]
- A. *No. I do recall it, now that you say it, a mention of it in the report and, no, I am not -- I suppose, my first inclination would be that that was an after the event note and, frankly, I would say it is completely irrelevant anyway. I mean, it's an equity fund, it's a cash fund and, I mean, you do not put 30% or 20% into property, never mind 70 or 80%. I mean, you could, maybe, justify 10% being in property or something so it's irrelevant in my mind. I mean, Harry tried to say that to me as well, 'Well, we had the discretion to invest in property' and I said 'Harry, don't even go there'. It's just nonsensical, you can't justify it. [24:17-24:28]*

**Ms Aleksandra Szelong on 22 July 2011**

- Q. If I looked at, let's say, the Destiny Equity Fund, I am aware there was a very large transfer of assets out of the equity fund into the European property funds in-- do you recall that transfer? [13:27-14:01]
- A. *European property fund? No. [14:02]*
- Q. Out of the Destiny Equity Fund, I believe a lot of equities were liquidated? [14:03-14:04]
- A. *There were some transfers out, but the information -- every time there is a transfer, I should receive back-up information regarding this. If not, I would chase it up and, let's say, receive an e-mail from typically John or Paul with the instructions. So I don't recall the particular transfer you are referring to. Mainly, the transfer would be to the Valovis Bank and some of them would be categorised as debtors. Despite asking for information, that's the only information I received as categorising the... [14:05-14:14]*
- Q. What percentage of the fund would that have made up of... [14:15-14:16]
- A. *The Valovis bond? [14:17]*
- Q. Well, let's say the ones that were recorded as debtors and you didn't have enough information or you had been requesting information and not getting it? [14:18-14:20]
- A. *I am not positive. [14:21]*
- Q. Even ballpark? [14:22]
- A. *20%, maybe. [14:23]*

**Further on in the evidence of Ms. Aleksandra Szelong**

- Q. Certainly one of the equity funds, I can't recollect which specific one it was, but there seemed to be at or in or around the same time a large encashment of those particular equities, so sales of a large portion of the fund that were in equity holdings and then that being transferred to, whether it be Valovis or some other institution in Europe, do you have any recollection of anything along those lines happening? [15:02-15:10]
- A. *Yes, there were transfers coming out. I had to reconcile those, yes, so I had to enter the sales of equities and book transfers. [15:11-15:13]*

- Q. But was there one occurrence where a lot of sales happened at the one particular time for the purposes of transferring then the total amount that was sold onward to, say, Valovis or similar institutions? [15:14-15:17]
- A. *I don't recall one particular time, but probably, maybe, half a year ago, something like this.* [15:18-15:19]
- Q. Say, late last year? [15:20]
- A. *Probably. I am not positive, but I would recall that it would be maybe around that time.* [15:21-15:22]
- Q. How were they reconciled back into the -- even taking the Valovis one, how were they reconciled back into the equity fund itself? What information would you be getting? [15:23-15:27]
- A. *The information, it would be reconciled based on the information provided by John and Paul because they instructed the investment into the Valovis bond.* [15:28-16:01]
- Q. Right? [15:02]
- A. *So they would have the knowledge and information on it. So I would go to them for the information. I would receive an e-mail with information on what the transfer was relating to and how to book it.* [15:03-15:06]
- Q. Okay? [15:07]
- A. *That was the only information I had as the basis of my booking.* [15:08]
- Q. Can you recall in relation to the bookings, can you recall what it was booked as? Was it booked as an equity or a bond or... [15:09-15:12]
- A. *It was booked as a bond.* [15:13]
- Q. Into the equity fund? [15:14]
- A. *Yes.* [15:15]
- Q. Do you know the amount... [15:16-15:17]
- A. *I think, actually, John booked it because I was waiting for information on the Valovis bond for quite some time and I wouldn't price funds without any back-up and I wouldn't book anything without any back-up. So I think it was entered by John.* [15:18-15:22]
- Q. Do you know the amount on that particular one, even roughly? [15:23-15:25]
- A. *A couple of million.* [15:26]

**Ms Leslie Coulter on 26 July 2011**

- A. *Yes, Brian Callahan from Appian came to me probably, probably some time during the week of, before the 8th July, so I think it was probably the Tuesday or the Wednesday.* [7:09-7:12]
- Q. Right, right. [7:13]

- A. *And had asked me was I aware of a transaction on the 21st March, and I said no and I wasn't here. [7:14-7:15]*
- Q. *This year? [7:16]*
- A. *This year, and he explained it to me that it was a three million Euro transaction had gone through. [7:17-7:18]*
- Q. *Yes. [7:19]*
- A. *And I think that was the starting point from what, from where they started... [7:20-7:21]*
- Q. *Yes. [7:22]*
- A. *...finding the problems. I said "absolutely not", and then I checked with Aisling, who would have been there at the time, and said "did this come through you?" and she says "no, absolutely not", and we keep, obviously we keep copies of all of our own stuff. [7:23-7:27]*
- Q. *Right. [7:28]*
- A. *And nothing of that had come past compliance. [7:29]*
- Q. *And that particular three million could you give any more details on that, just for the record? [8:01-8:02]*
- A. *It was three million transferred into, I think it is Vasovia (sic), Vasovius (sic) or... [8:03-8:04]*
- Q. *Valovis is it? [8:05]*
- A. *Valovis bank. [8:06]*
- ...
- A. *And it was put against a property. [8:08]*
- Q. *Right, and that transfer came out of? [8:09]*
- A. *Out of one of the equity funds. [8:10]*
- Q. *Right. [8:11]*
- A. *Okay. So that is my, that would be the first time that I would have, sort of had oh well that doesn't sound right. [8:12-8:14]*

**Ms Ciara Kelleher on 22 July 2011**

- Q. *Which funds were they? [58:03]*
- A. *The PRSA funds because she had priced them before they went to Rob. Like, I told Brian in Appian that I literally had nothing to do with them. Like, the first time I heard of that Valovis bond thing was when he was standing beside me going 'What is the Valovis bond?' and the only reason I got to print that information was because he was asking for it for so long and, in classic style, nobody replied to him. Like, from the Friday... [58:04-58:12]*

Q. Sorry, reply to who? [58:13]

A. Brian, when Brian in Appian... [58:14]

Q. Oh, yes, right. [58:15]

A. ...was looking for the details of the funds and Patrick Lawless<sup>6</sup> had rung Aleks on the Friday and Alex asked John to deal with it and John said he would, just for the information on the funds. Now, literally, I mean, I've had nothing to do with them except I know she does them and gives them to John and it was more like an inherited function within our team because it really shouldn't sit with us, but that's beside the point. That was on the Friday and then, on the Monday, she was there going 'I'm worried that John hasn't replied and then it looks bad to our new employer that I haven't replied, even though I've given it to John' and John had told her not to reply to them. Then when she got worried on the Monday, he said 'Well, reply and tell them I'm doing it, I'm handling it', which she did. Then there was still no answer and I actually said to John 'You're freaking Alex out. If you're not replying...' and he said 'No, Harry has to reply on this'. I said 'Well, somebody reply or tell Appian that you guys are replying and leave Aleks alone' because Patrick Lawless came in again to her asking her the same information and saying 'I expect you to supply it'. So she is obviously freaking out, like, because she's at staff level. You know, she shouldn't have to, when she's being told...So it was on the Tuesday then that Brian rang and said 'You give me the information on this' and I said 'I don't deal with these funds' and I said 'I can look it up on Unity for you' and I said 'But is this not the stuff you are asking from John and Harry?' and that's when the shit hit the fan literally and he blew up, going 'You have to give it to me'. I said 'I have no problem giving it to you, but I don't know anything about the funds'. Then he was down beside me in about two seconds flat and then I looked it up and I saw this Valois and he said 'What is it?' and I said 'I have no clue'. [58:16-59:24]<sup>7</sup>

#### **Sworn written statement submitted by Brian Cahalin dated 4 August 2011**

**Wednesday 6 July 2011:**

**11:00**

"I spoke individually to Ciara Kelleher, Aisling Barrett and Michelle Donnelly. I gave the same message to each I stated that I was aware of issues with Equity funds and that I needed to know any issues now and not later. I felt Michelle Donnelly had information that she was not willing to share at this point. I advised her that I sensed this and that I didn't expect an immediate response. I said I would be available on mobile if she wanted to say anything. She questioned what her position would be if she did provide some information. I said I didn't know but on balance that if she did have information she should present it to us. Ciara Kelleher requested I didn't speak to Alex Szelong and Susan Fennell as I might "spook" them. I chose to heed this request."

**14:00**

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<sup>6</sup> A director of Appian Asset Management Limited

<sup>7</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

“I received a call from Michelle Donnelly requesting me to meet her to advise of certain matters. We arranged to meet 10 minutes later. Michelle Donnelly explained that she made payments that she knew were incorrect, had told Harry Cassidy that she would not participate some time back but was aware that the practice was ongoing. *NB This is slightly inconsistent as the example she sent later in the day only serves to highlight the practice of amending account records prior to sending out valuations, whereas Michelle Donnelly’s comment suggest the payment was wrong in the first place.*”

### 3.3 Forensic Examination by KPMG

#### Destiny Equity

#### Summary of NAV of Destiny Equity 22 June 2011 from CHC systems

	Destiny Equity Fund
	€
Cash	20,169
Equities	1,286,757
Solarprint	63,990
Mezz	2,987
Bonds	9,628,909
Debtors	599,343
Creditors	(32,310)
Interest accrual	282,850
Fee accrual	(19,652)
	11,833,043
No of clients	120

#### Bonds

The amount making up the Bonds holding is €9,628,909 and in the valuation statement prepared by CHC dated 22 June 2011, this amount is made up of five separate bonds, one with Saar Landesbank of €2,148,188, and four with Valovis Bank - €364,125, €3,989,547, €3,016,599 and €110,450.



The CHC nominal ledger indicates that 26 separate payments were made [KPMG exhibit 54] and these amounts are classified as amounts owed by five property funds. The payments were all made in the period September 2010 to December 2010. An email from Paul Lavery to Harry Cassidy on 8 July 2011 sets out the details of the payments made. [KPMG exhibit 55]

Of the payments from the Destiny Equity bank account of €9,628,909, the majority related to payments made to German, Spanish and Luxembourg banks in connection with property investments held by special purpose vehicle companies that were funded by the banks. However, certain payments were not, including:

- €40,000 was transferred to Merrion Stockbrokers on 8 September 2010 in relation to CLIENT 12's ARF. [KPMG exhibit 56]
- €88,705.52 was transferred to CHC's current account on 13 September 2010 [KPMG exhibit 55]. The information on the schedule provided by Paul Lavery to Harry Cassidy on 8 July 2011 indicates this relates to CHC fees.
- €101,675 was transferred to CHC's current account on 24 September 2010. The information on the schedule provided by Paul Lavery to Harry Cassidy on 8 July 2011 indicates this relates to CHC fees. John Whyte authorised this transfer and the funds were transferred from a Merrion account, along with another amount of €300,000 which was paid to La Caixa. On 24 September Paul Lavery emailed Harry Cassidy to say "funds have just hit from Merrion. Can you approve the transfer of €300,000 to Los Collados." Harry Cassidy responded "Approved. Get bond done to match transfers." [KPMG exhibit 58 and 59]
- €20,500 was paid to CHC's current account on 15 October 2010, to part refund payment made to a client. This was authorised by Mr. Whyte and Mr. Cassidy. [KPMG exhibit 60]
- €590,000 was paid to Permanent TSB in respect of CLIENT 13's ARF. This transfer was approved by Harry Cassidy [KPMG exhibit 61]. It would appear that the client was informed that funds of approximately €1m were held for him in Client Asset Gross Savings account when the actual balance was approximately €6,900. His funds were invested in Parkstadt and when he sought repayment of his funds, they were paid from the Destiny Equity account.
- €35,000 was paid to CLIENT 15 PPT. [KPMG exhibit 63]

None of the above amounts relate to amounts invested in bonds. It was confirmed to KPMG by CHC staff that none of the payments to Valovis Bank or other banks related to investments in bonds.

## Debtors

Payments totalling €442,388.89 were made from Merrion accounts holding Destiny Equity funds. [KPMG Exhibit 64]. The majority of these amounts were paid to German, Spanish and Luxembourg banks in June 2010, with the exception of the following:

- €50,000 was paid to Bank of Ireland in respect of CLIENT 15 and CLIENT 16; [KPMG Exhibit 65] and
- €33,436.56 was paid to CHC's current account appearing to clear overdrawn rental positions on two client funds.
- Three amounts of €968.07 were paid to Destiny Gilt, Destiny Cash and Destiny Property to cover fees.

## Destiny PRSA Equity Fund

### Summary of NAV of Destiny PRSA Equity Fund (11 July 2011)

	Destiny Equity Fund	PRSA
	€	
Cash	17,769	
Equities	1,999,982	
Bonds	4,752,065	
Debtors	2,049,747	
Interest accrual	102,107	
Fee accrual	(3,179)	
	8,918,591	
No of clients	154	

## Bonds

The amounts making up the Bonds holding is €4,752,065 and in the valuation statement prepared by CHC dated 11 July 2011 [KPMG exhibit 66], this amount is made up four bonds with Valovis Bank - €3,315,106.88, €1,113,996.50, €305,461.97 and €17,500.

Indications are that 22 separate payments were made and these amounts are classified as amounts owed by nine property funds. The payments were all made in the period November 2010 to March 2011. [KPMG exhibit 67] An email from Paul Lavery to Harry Cassidy on 8 July 2011 [KPMG exhibit 68] sets out details of the payments made.

The majority of the amounts were paid to French, German and Spanish banks with the exception of the following:

- €150,000 was transferred to Destiny PRSA Select II on 11 November 2010, on instructions of Mr. Whyte, to cover a payment to Merrion in respect of CLIENT 17 [KPMG exhibit 69];
- €12,956.56 and €12,393.78 were transferred to Destiny Client savings, to clear overdrawn positions on individual property funds, €25,000 was paid to CLIENT 18 PPT, and €10,000 was paid to CLIENT 19 PPT [€12,393.78 and €25,000 payments referred to in KPMG exhibit 70];
- €80,000 was transferred to Bank of Ireland in respect of placing money in a bond on behalf of CLIENT 2. He had been informed his funds were in Client Asset Gross Savings, when they were invested in Parkstadt. [KPMG exhibit 71]
- €295,000 was transferred to Permanent TSB in respect of CLIENT 13. This relates to the €590,000 payment made from Destiny Equity above. [KPMG Exhibit 61]
- €305,053 was transferred to M&F Euro Account on 21 March 2011. This appears to relate to a repayment of funds owed to CLIENT 20 in respect of Destiny Property 90. [KPMG exhibit 72]
- A payment totalling €3,010,053 was made to Valovis Bank on 7 March 2011 on instructions of Mr. Cassidy in respect of two property funds (Holstein Retail SA and Schleswig Retail SA). [KPMG exhibit 73]
- Both of these payments (€305,053.58 and €3,010,053) were treated as investments in a Valovis Bond. [KPMG exhibit 74]
- It appears that these two payments were funded by the encashment of equities held by Merrion totalling €4,054,164.61 on 3 March 2011. [KPMG exhibit 75]

None of the above amounts relate to amounts invested in bonds. It has been confirmed to KPMG by CHC staff that none of the payments to Valovis Bank or other banks related to investments in bonds.

## **Debtors**

The amount included as debtors totals €2,049,747.22 relating to four transactions of which two amounts totalling €805,000 was paid directly to German and French Banks. In addition:

- An amount of €744,100.35 was paid to CLIENT 21 in respect of the transfer of his cash balance. It appears that he received a statement advising him that he had invested €735,000 in Destiny 140/Los Collados instead of cash. There was insufficient cash to repay his investment and the repayment was made from this account. [KPMG exhibit 76 and 77]
- An amount of €500,646.87 was paid to Bank of Ireland from a Merrion account on 13 August 2008. This is in relation to the redemption of a loan but KPMG have been unable to identify which loan this related to. [KPMG exhibit 78]

### **3.4 Conclusions**

It is clear from a review of the holdings in the Destiny Equity Fund and the Destiny PRSA Equity Fund that the greater part of the assets within these funds were deliberately converted to cash and used to support various CHC client property investments without client authorisation and contrary to the purpose of the Funds. Assets were also used for the purposes of meeting (re)payments requests from other clients unconnected with these funds.

The Inspectors have concluded that both equity funds had ceased to operate in the manner for which they were established and that the equity funds could not meet the legitimate requests from clients for their investments in the funds to be realised and cash returned to them.

It is beyond question that the transfer of money from these equity funds to become loans in commercial property vehicles was entirely inappropriate. The current holdings of these funds still do not represent equities as the assets now held are primarily loans to SPV property investments.

#### 4. DESTINY POOLED BANK ACCOUNTS AND INDIVIDUAL BANK ACCOUNTS UNDER THE DESTINY EXEMPT UNIT TRUST STRUCTURE

##### 4.1 Introduction

As mentioned above the Destiny Exempt Unit Trust structure (“**Destiny**”) is set up as an exempt unit trust umbrella structure, under which a large number (over 200) of individual sub-trusts have been created. This is the principal structure through which clients of CHC have invested pension monies into property.

The trustee and legal owner of Destiny assets is M&F Finance (Ireland) Ltd (“**M&F**”), a company chaired until recently by Mr Harry Cassidy with a number of directors in common with those of CHC. Other than the directors, M&F would appear to have no dedicated staff. The beneficial owners of each individual exempt unit trust (“**EUT**”) are the clients of CHC and the Investment Manager is CHC. (See section C18 for further details on M&F)

Typically an individual or a small group of individuals would agree to purchase a property (or properties), identified either by them or CHC, with the objective of purchasing it as a pension investment. An individual exempt unit trust would be created as a sub-trust within the umbrella to acquire and hold the property. In the event that borrowing is required this could also be obtained through the sub-trust, with M&F securing the finance on a non-recourse basis to M&F or the unitholders. Each sub-trust is referred to within CHC by a number, e.g. Destiny 20, Destiny 51, etc. Money may also be transferred to the sub-trust by the unit holder to cover ongoing costs such as loan repayments. Ideally rental income would cover the cash needs of the sub-trust (running expenses, mortgage finance etc.) as they fall due, with any excess typically being held in one of the Destiny pooled cash bank accounts.

A further 18 sub-trusts are referred to as ‘syndicated/commercial’ in that the underlying properties are commercial property holdings (all except one of which is located in the UK) and the number of investors in each ‘syndicated’ sub-trust ranges from 2 to 125.

Underneath the Destiny umbrella, as stated previously, a number of other sub-trusts were created with the intention of investing in other asset classes, such as cash and equities, e.g. Destiny Equity Fund, Destiny PRSA Equity Fund, Destiny Cash Fund, Destiny PRSA Cash Fund, etc.

The Destiny structure as set up and managed by CHC operated with a number of pooled and individual trust bank accounts. The individual trusts typically used pooled accounts and were operated by CHC. Cash invested in and income from investments held within the individual sub-trusts would normally be lodged into one of these pooled accounts while

payments in respect of loan obligations, maintenance, etc., made on behalf of each individual sub-trust would be drawn out of one of these accounts. In both cases corresponding entries would be made in the accounts of the individual sub-trust. In general the larger 'syndicated' trusts operated separate bank accounts.

Apart from having a common manager and trustee, each individual EUT under the Destiny structure and client(s) who had invested in it would have no connection with any other EUT/client(s). Clearly payments should not be made out of the pooled bank accounts unless the relevant underlying EUT is identified for the purpose of the transaction (with regular reconciliations carried out on the account to ensure that the account of each individual EUT is properly funded) and should only be made in respect of legitimate expenses/investments related to that fund. However the Inspectors found that CHC managed these pooled accounts in such a manner that payments were made out of them to meet obligations of an individual EUT without first ensuring that the EUT had sufficient funds for this transaction. Payments made in this fashion were recorded by CHC as a loan from Destiny 1 to Destiny 2 or from perhaps a number of Destiny sub-trusts to Destiny 3, but it is likely that some of these inter-trust loans will not be capable of being repaid. Similarly payments were made, typically into the individual bank accounts of the 'syndicated' sub-trusts, out of the pooled accounts. Also payments were made out of the individual accounts of one 'syndicated' sub-trust into the account of one or more other 'syndicated' sub-trusts.

The Inspectors estimate that, through the operation of the pooled accounts, significant transfers of cash have been made from EUTs which, at the time of such transfers, were in surplus to other EUTs, which are represented as creditors/ debtors in the records of the trusts, as maintained by CHC. Whether amounts thus due from one EUT to another will be recoverable from the recipient EUT remains to be determined on a case by case basis. As appears from Section 4.3, approximately €6.5 million was moved to a select number of typically commercial/syndicated trusts from other sub-trusts within the Destiny structure. The scale of transfer payments (booked as inter trust loans) between other trusts, typically operating on a smaller scale than the syndicated trusts, cannot be assessed without a thorough reconciliation exercise being carried out.

#### **4.2 Sworn testimony to Inspectors**

The witnesses called by the Inspectors were asked to describe the Destiny structure, comment on whether they were aware of a process whereby funds from one sub-trust may have been used to fund the expenses of another or others and asked who authorised such payments.

The following statements, including questions where relevant, are taken from the sworn testimony of those witnesses:

**Mr Harry Cassidy on 19 July 2011**

Q. I understand that there were about seven pooled accounts, a Sterling pooled account, a Euro pooled account, a client savings pooled account and so on? [39:22-39:24]

A. Yes [39:25]

Q. But that the income, i.e. rents in the main, from all of the unit trusts, including the commercial, would flow into one of those accounts and that the invoices being raised for maintenance or mortgages or whatever would also come out of those accounts?[39:26-40:01]

A. *It could yeah. I mean, some of these accounts – and Liam would be better able to explain it than I would because he looks after it, the pooled accounts were done on the basis to collect the rents and to make payments out. In fact, all of the commercial, as I understand it, are segregated because the bank required that as part of the facility.* [40:02-40:08]

Q. So a separate segregated bank account in their own name that would only accept and make payments... (INTERJECTION) [40:09-40:10]

A. *Yes but what we did have permission to do, though, was within say -- let's take one from 173 as a property -- that if there was a shortfall in 66, we would use some of the rent from 66 to support 173 until 173's rent came in and then we would replace it back in 66.'* [40:12 - 40:16]

Q. On what basis would that have been done? Would that have been done on the basis of an understanding with the client or... [40:17 - 40:19]

A. *No, it didn't need to be with the client because the unit trusts -- you know, the client held units in the unit trust and not the unit trust itself and, therefore, the managers<sup>8</sup> -- that was us -- we had that agreement with the bank, Bank of Ireland in the main. So they would be aware that we would use cash from a pooled fund to support loans until the other cash -- because, usually, it was just a timing issue so if, say, in fund 173, the rents, say, hit the account on the 6th of the month but the bank loan went out on the 3rd of the month, there may be a shortfall until we got that and then, when the rents came in on the 6th, we would apply it back to the account that we had supported.* [40:20 - 41:04]

Q. My understanding, and maybe you can correct me if I am wrong, is that the amount of loans -- let's call them loans between these accounts -- and, in particular, from the residential accounts to the commercial accounts is pretty high at the moment because of shortfalls in a lot of these cash accounts? [41:05 - 40:10]

A. *There is a definite shortfall on the Destiny fund because Liam has brought it to our attention a couple of times and we are trying to find ways to rectify that. I don't*

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<sup>8</sup> The interviewee subsequently stated by email: "as we are talking about the operation of unit trusts clients individually did not need to be consulted. The clients only hold units the inv manager has control on assets. There was no obligation to inform investors"

*know what that amount is because the account hasn't been rec'd, so there is a Destiny client savings account and there are literally thousands of transactions on it and, when we were doing the work last weekend [16/17 July 2011], it was brought to my attention that it hadn't been reconciled and it would take I don't know how long to reconcile that, but it certainly is a massive job because every property has gone through that and every transaction has gone through that and if you multiply each property by 50 transactions for 50 clients plus that, then you are into thousands. Well, I don't know the figure off the top of my head. Liam might have an idea but, when I was speaking to him a few days ago, there certainly wasn't any indication exactly what the hole might be in that. [41:11 - 41:28]*

Q. But it would run to millions? [41:29]

A. *I don't know.* [42:1]

#### **Further on in the evidence of Mr. Harry Cassidy**

Q. Well, being quite cards on the table, putting all of the customers who feel that they have cash, have equity positions, back into those positions and resolving the situation where, maybe, Peter's money has been borrowed to pay Paul in the context of the pooled accounts, if all of that was done as of now, could the company do that? Could the company put people back in a position they probably should be in? [88:25 - 89:04]

A. *Well, it couldn't because the company doesn't have those resources, but that's not to say it couldn't be done carefully...* [89:05 -89:07]

#### **Further on in the evidence of Mr. Harry Cassidy**

*I would, for all my faults, of which I have many, and I have caused problems, of which I have caused many, but I do know the property market inside out and I do know the European market and I do know that there are a number of very significant pension funds and insurance funds very keen to get their hands on some of our assets and at a price that would be a lot better than a forced sale if an examinership or some other act like that was to take place. There are significant fees due to CHC within those portfolios and those monies can be used to offset difficulties that clients have and to restore their position to where they should be. [90:03 - 90:15]*

#### **Mr Paul Lavery on 19 July 2011**

Q. As I understand it...all income and all expenditure flowed out of those pooled accounts...? [18:17 - 18:19]

A. Yes. [18:21]

Q. Did that strike you as a proper way to do business? [18:22]

A. *No, it didn't, to be honest with you. I suppose, at the start, it took me a few years to get into knowing how the system worked and I was told at the start that these accounts are set up and the money in those accounts were property specific and it was for property investments, so that was my initial understanding. Then, after a while, I said you can't be doing this, you know. [18:23 - 19:01]*



**Further on in the evidence of Mr. Paul Lavery**

*You have to segregate the accounts into separate entities and -- sorry, have separate bank accounts for each... [19:03 - 19:05]*

**Further on in the evidence of Mr. Paul Lavery**

Q. What is the current status of those accounts? [19:13]

A. *We looked at it and some stuff hasn't been posted correctly in the system, so a full reconciliation would need to be done for each entity and gone through in detail and allocate the specific transactions to whatever property it was related to and then say, at the end of the day, you have X here and X there and you say 'Listen, these are the balances which are on each account -- they're negative here on one account, there's a positive there, these are the balances'. Like, that is a massive piece of work. [19:22 - 20:02]*

**Further on in the evidence of Mr. Paul Lavery**

Q. If I ask you then just after all we have said here to just take a step back and say where you think the clients of CHC have most to worry about, what would you say? [49:29 -50:03]

A. *It was my worry and has always been my worry that, you know, you are a client yourself, it's getting your pension, it's your livelihood. That's it. You work hard and come out with nothing, like. [50:04 - 50:07]*

Q. I suppose, to be more specific, where in the company's portfolio of services are the problems most obvious? Is it the pooled accounts, is it the European accounts? Are there other issues that we should be aware of? [50:10 - 50:13]

A. *I suppose, it would be the pooled accounts because it's reconciling them that's going to be a massive job. [50:14 - 50:15]*

Q. Is this on the Destiny? [50:16]

A. *Yeah, it's a massive job to do that. Like, on the Client Asset accounts, you can identify -- okay, there's always a trace for everything, but you identify clearly what clients are involved, but it is the Destiny ones are a different area altogether. [50:17 - 50:21]*

**Mr Liam O'Reilly on 18 July 2011**

A. *And the CH Commercials, however, there were still a number of invoices paid that -- whereas there may be no money in the account because the fund would go under if they were not paid. [19:26-19:29]*

Q. Right. But I presume that that means that other clients are effectively subsidising -- client A might be subsidising client B, whose fund... [20:01-20:03]

A. *Correct. [20:4]*

Q. Right. Without knowing it? [20:05]

A. *I'm trying to -- I think you're very correct on that, George. They would only have investment -- they would only have units in a fund and they wouldn't know at level what cash is held. [20:06-20:09]*

**Further on in the evidence of Mr. Liam O'Reilly**

Q. Right. Okay. The problem being some are under water. [20:27]

A. *Exactly. And the money isn't there. It has been very, very difficult the last few months. [20:28-20:29]*

Q. All right. Okay. So in the context of I suppose the clients statements in relation to -- well, the areas that you're familiar with, Liam, are -- would it be true to say that some of those clients, their unit position there is not really reflecting the true position if -- if the pooled accounts were pulled apart?[21:01-21:07]

A. *I sign off on them and I stand over it, you know. They're 100 percent accurate. The issue is, if that client, you know, wanted to sell his property in the morning, and maybe there was a cash balance of 100,000 in one of these accounts, it may be difficult in getting that out. [21:17-21:22]*

**Further on in the evidence of Mr. Liam O'Reilly**

A. *Yes, exactly. So I would say that there is only about 20 commercial properties, but there is big negative balances from the UK commercial properties. [26:09-26:11]*

Q. And would all of the commercial ones be syndicated? [26:12]

A. *They would, yes. As far as I know, and I'm trying to think if there is any that aren't. No, we have one that has two investors but usually -- typically you would have 30 or 40 investors in it. [26:13-26:16]*

Q. So am I correct in saying then that insofar as you are aware the invoices would continue to be paid on some of these underwater commercial properties? [26:17- 26:20]

A. Yes. [26:21]

Q. And they are being taken out of effectively the Destiny client savings? [26:22]

A. *It could be any pooled account, yes. I mean someone was set up from our team, but we would have -- I mean Harry, perhaps he would have given us approval to do it, and basically told us an instruction to do it, sorry. So I mean there is e-mail trails behind it, and we have sent -- how it's based on instruction, whereby invoices had to be paid. [26:24-27:01]*

Q. Would those instructions be verbal or were they... [27:02- 27:03]

A. *They would be a bit of both. I say there is a hell of a lot of e-mails. [27:04-27:05]*

Q. They would still be there, would they? [27:06]

A. *Oh, yes, they would still be there, yeah. [27:07]*

Q. Like to you, telling you what to do? [27:08]

A. *Yeah, they would be, or they would be to Paul Lavery as well.* [27:09-27:10]

**Further on in the evidence of Mr. Liam O'Reilly**

A. *No. Rental income -- I mean rental income, which my team booked is booked in the account it relates to. It is never a case of rental income comes in and it's -- the credit is put on a different person's account. It is always put on the account it relates to. But indirectly, obviously, if it comes into a pooled account...* [32:19-32:25]

Q. Yeah. I suppose that is where I started. That's again back where we were. It appears as correctly assigned to client No. 58, but in fact it flows into the pooled account and might actually flow out for an invoice on the commercial property in the account? [32:26-33:01]

A. *Correct. Indirectly, correct.* [33:02]

Q. Okay. Well, did you yourself have an authorised signatory power or that? [33:03-33:04]

A. *Well, like I said, I can set up transfers. Everybody in my team can set up transfers. So we hire the people, you know, my team hire the people who do most of the transfers.* [33:05-33:08]

Q. So you'd originate a transfer for an invoice? [33:09]

A. *And we send it on to the financial controller for approval.* [33:10-33:11]

Q. Okay. So they would be the ones signing off on this? [33:12-33:12]

A. *Yes, they would sign off on it.* [33:13]

A. *The odd time, if Paul Lavery was out, Michelle Donnelly would sometimes sign off on it.* [33:15-33:16]

**Further on in the evidence of Mr. Liam O'Reilly**

A. *But generally Paul signs off on it.* [33:18]

Q. Right. So you would raise I suppose -- you raised the payment but somebody else would authorise it? [33:19-33:20]

A. *I mean I'm there three years. There is a lot of things my team do. I mean, we do the payments. We have access to the online so if we need an invoice to pay, it's set up online, and it gets approved then with the financial controller.* [33:21-33:25]

...

A. *And sometimes, if it is an invoice for one of the CHC expenses, Harry usually asks maybe to do it.* [33:27-33:28]

**Mr Graham O'Reilly on 18 July 2011**

- Q. Yeah. And the transfers in and out of those, how was the cash managed for all of those properties? [12:06-12:07]
- A. *They are all in pooled accounts. So we have Destiny bank accounts.* [12:08-12:09]
- Q. Right. How many pooled accounts would there be? [12:10]
- A. *We would have -- we would have seven Destiny bank accounts. We could have had another eight or nine. Off hand I wouldn't have an exact figure. But there is a good few of them, you know.* [12:11-12:14]
- Q. Right. So who would be pooled in let's say one of those pooled accounts? [12:15-12:16]
- A. *Well, every Destiny property would have their money held within the pooled account.* [12:17-12:18]

**Further on in the evidence of Mr. Graham O'Reilly**

- A. *So we stopped paying the loans for people that didn't have the money* [16:06-16:07]
- Q. Right. [16:08]
- A. *But out of the other ones, the UK commercial funds, they are a lot bigger and you couldn't stop paying loans on them because they are closed funds. You have got all of the contributions in from your investors since Day 1.* [16:09-16:13]
- Q. Right. [16:14]
- A. *So the agreement that you had with the bank there is the loan had to be paid every quarter. So if there are some shortfalls on a couple of funds, that had to be covered, you know.* [16:15-16:18]
- Q. Do you have any idea how to quantify that? [16:19]
- A. *I wouldn't, to be honest.* [16:20]
- Q. Right. Okay. So if I am hearing you right, and maybe if I just paraphrase, correct me if I'm wrong, that the UK Commercial funds are so big, I suppose, that you continued to pay off invoices from pooled cash accounts? [16:21-16:25]
- A. *Yes, that does occur. Some of them are. Some of them washed their own faces. They have -- they get enough rental income in, and they are okay. But some other ones, the way they were set up, they never had enough money.* [16:26-17:01]
- A. *So obviously we have to pay the invoice as they come due, you know.* [17:03-17:04]
- Q. Is that because the tenant income is not paying for the... [17:05]
- A. *That's right. It could be one reason or it could be that there was never sufficient equity brought in from day 1, so we are chasing our tail from day 1.* [17:06-17:09]

- Q. So that the loan amount was much higher than it should have been? [17:10-17:11]
- A. Yes. So we should have got 8 million in equity and we got a loan for 5 million, but we only got 6 million in equity, so you're chasing that 2 million then the whole time. [17:12-17:15]
- Q. Right, okay. [17:16]
- A. So then you have no money to pay invoices or anything like that going on. [17:17-17:18]
- Q. Okay. Was there ever any attempt to plug that using money from other clients? [17:19-17:20]
- A. Well, that's -- that's the theory of pooled bank accounts. [17:21-17:22]

**Further on in the evidence of Mr. Graham O'Reilly**

- Q. If I were to ask you to explain to a layperson, which in this kind of case, I am, what a property log sheet is, what is that? [20:02 -20:04]
- A. That is basically the list of legitimate investors from Day 1. Who wanted to invest in this fund, and the amount they invested in it. [20:05-20:07]
- A. So we would cross check the property log sheet with a report that we could run from Unity to show who was actually invested in this property, and we would cross check the names and the amounts. And we were cross checking the names and amounts, and we came across a few clients here and there that shouldn't have been invested in the property, so we highlighted them. [20:09-20:15]
- Q. Right. And can you recall what that added up to by any chance? [20:16-20:17]
- A. That added up to -- I think the grand total, including-- there is another sort of account, Stockbroker account, where that was 1.4 million, the Stockbroker account was. This is whereby clients had money leaving their back account, the pool bank account, and not booked anywhere. Just hit this Stockbroker account. [20:18-20:23]
- Q. Right. [20:24]
- A. And that was 1.4 million, and beyond all the other... [20:25]
- Q. So in reality that account has nothing that was put into the property, I presume? [20:27-20:28]
- A. It probably ended up that way, yeah. But it wasn't booked, it was just booked as money leaving their account. [20:29-21:02]
- Q. Out of let's say -- [21:03]
- A. The client asset gross for the Destiny client savings. Money cashed -- they should have in account is gone, and all you can see is just transfer. [21:04-21:06]
- Q. Right. [21:07]

- A. *So that totalled up to 1.4 million for about 34 clients. [21:08]*
- Q. Okay. [21:09]
- A. *And then on the funds side, on the French and German funds, from the reconciliation of the property log to the Unity log, we totalled up to about 10 million, was invested in these funds that we didn't have any corresponding entry on a property log. [21:10-21:14]*
- Q. So this would again have come from let's say the Destiny client savings, but as a direct transfer to one of these SPVs? [21:15-21:17]
- A. Yes. [21:18]
- Q. In relation to these accounts, these pooled accounts, who were the signatories and who could operate them? [21:19-21:21]
- A. *The pooled accounts were basically, to do any transfers or to sign off anything, it was -- we would set it up on banking online, go transfer from Destiny client savings to wherever it was going, pay an invoice or that. So we would part authorise it and then we would transfer it to the financial controller, Paul Lavery, and then he would final sign off and send it where it would go. [21:22-21:29]*

**Further on in the evidence of Mr. Graham O'Reilly**

- Q. Okay. Graham, would you have any idea or would you have seen, other than as we have discussed in terms of the pooled accounts here, any instance where cash or other assets received from clients, from one set of clients was used to satisfied a cash flow requirement of another client? [30:04-30:09]
- A. *Well, what we have identified over the last couple of weeks is, we were backing up any Stockbroker issues we found, I did back up into when the actual money left the bank. [30:10-30:13]*
- Q. Is this the Stockbroker holding account? [30:14]
- A. *Yes, this holding account. So you see the man's money coming out of his cash account, and then we book it on the other side, and that entry would be Stockbroker. [30:15-30:17]*
- A. *So I looked into exactly when -- when did this transfer actually go out of the bank. [30:19-30:20]*
- A. *How much was it for. And in a couple of them you would find out that about say 400 grand was transferred on that day across to Germany, but it was booked under 12 accounts split up under 12 accounts. [30:22-30:25]*
- A. *So obviously these 12 accounts were covering that transfer. [30:27-30:28]*
- Q. Right. Okay. [30:29]
- A. *And then you would have another occasion where one client needed to get certain invoices paid. This would have come across over the last two weeks, now, and his cash wasn't on his cash account when it should have been. He had obviously investments that should have been booked there, so you would need to get his cash from somewhere else, back into his account to pay his invoice. So you could see*

*bookings on other accounts, money going out, and ten your man would have his money again on his side, and then he would pay the invoice. So that that would be a prime example of that. [31:01-31:11]*

#### **Ms Suzanna Cummins on 8 August 2011**

- Q. Just to take a totally different side of the business, would you have had much interaction on the property side with the Destiny structures and the pooled cash accounts, the gross savings account and the net savings account and all the rest? [33:04-33:08]
- A. *Only to the extent that I had mentioned where there was an issue with the reconciliation on one of them and I actually went and did that myself. That was the only-- and the reconciliation -- there would have obviously been with the transaction approvals, but I don't really remember there being any specific issues with -- I mean, where the clients would have approved the transfer of payments of money from their account for Destiny, it would have come from one of the Destiny cash accounts, I would imagine, unless they were using money that they brought in through I suppose I'd call it the regulated CAR account. But there was never anything that, certainly from the clients' side, that I would have seen that would have raised any concerns. [33:09-33:22]*
- Q. What did you think in general about the use of the pooled cash accounts in the manner that were used in the Destiny structure? [33:23-33:25]<sup>9</sup>
- A. *I think I have voiced this even at the Mezzanine Bond meeting. Even the postings were -- how should I say this? As an accountant, there is a certain way you conduct cash accounts. There is certain things I expect to see. I expect to be able to say for that payment there, what was that for, where did it go to, what client is it for. I expect to see reconciliations being done on a daily, if not weekly, basis and none of that was being done. I mean, just standard accounting, I suppose, I got more excited and upset about that with Paul because I have an accounting background. Postings, there was always a shortcut taken for postings. You know, instead of doing, if you had three postings to do, they would just take the net effect and just post that. Does that make sense? [33:26-34:11]*

#### **4.3 Forensic Examination by KPMG**

There appear to be eight pooled cash accounts into which the sterling and euro receivables, and from which expenses, should be paid on behalf of most of the smaller Destiny trusts.<sup>10</sup> The larger Destiny commercial/syndicated trusts have their own bank accounts.

The Inspectors asked KPMG to review these pooled accounts. The Inspectors and KPMG have not attempted to undertake a reconciliation of the various accounts of the various Destiny sub-trusts, the pooled cash accounts or the individual bank accounts of the larger

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<sup>9</sup> Interviewee submitted the following statement: "I disagree with the manner in which the accounts were set up and there was a discussion held to restructure the cash accounts by setting up segregated and individual cash accounts for each destiny unit trust. However what I cannot remember is how much progress was actually made to complete this. Then from April 2010 onwards, as there was going to be a restructure of the business anyway, this plan was not on my priority list for completion, until the full extent of the CHC restructure was known". [Signed letter dated 9 August 2011 from Suzanna Cummins]

<sup>10</sup> The accounts were designated as BoI NI current, BoI NI rental, BoI NI deposit, Destiny client savings, Destiny rental current, Destiny property current, Destiny cash current and M&F euro account.

commercial/syndicated sub-trusts. Such an exercise would of itself take significant resources and several months to achieve. This report focuses on those issues which appeared to be most critical to understanding the extent to which and how CHC may have misused client cash and assets to fund equity shortfalls in property investments and meet cash demands where the relevant assets/cash was not available.

Details are set out below of transactions on one of the pooled cash accounts, namely the Bank of Ireland Northern Ireland Deposit a/c number XXXXXXXX (“**BOI NI Deposit**”). This account has been selected as an example, and to avoid a repetition of what would be broadly similar corresponding information. The Inspectors are satisfied that there was a general policy of invoices relating to a given sub-trust which did not have available cash (by reference to its accounts maintained on the CHC Unity system) being nonetheless discharged by using cash from one of the pooled accounts.

(a) BOI NI Deposit

This account is a sterling account held in Bank of Ireland Belfast and is one of the pooled cash accounts that the individual trusts operating in the British property market would normally use. The account as of 8 August 2011 showed a balance of £324,009.91<sup>11</sup>. KPMG, using the ledger on CHC’s UNITY accounting system, took a snapshot of the position of all creditors and debtors to that account as of the same day [KPMG Exhibit 1]. This indicated that 179 trusts and other users of the BoI NI Deposit account had either positive or negative balances on the day. A review of this shows that there were significant negative balances owing to the BoI NI deposit account and that by far the most significant by number and value of these were in fact commercial/syndicated trusts and in some cases European property funds – all of which have, and hence would be expected to operate exclusively out of their own separate cash accounts. The Destiny 171 commercial/syndicated trust was chosen by the Inspectors for further investigation.

(b) Destiny 171

The assets of this trust comprise a property including restaurants, offices and apartments in Newcastle upon Tyne and it maintains its own Bank of Ireland Belfast sterling account. In common with the majority of other syndicated/commercial investments of EUTs in the United Kingdom it is funded by mortgage finance

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<sup>11</sup> The £324,009.91 was taken from the Unity System – the balance on the actual bank statement was not reconciled and showed a lower balance of £103,145.06



provided by Bank of Ireland. A snapshot of its ledger account on the Unity system as of 8 August 2011 [KPMG Exhibit 2] showed that it owed the BoI NI Deposit account €108,702.27 (equivalent to £94,928.39). However it also showed that it owed the other pooled cash accounts an additional net aggregate amount of €621,747.45<sup>12</sup>. This suggests that as of 8 August 2011 CHC had arranged for the Destiny 171 commercial/syndicated trust effectively to borrow a net total of €730,449.72 from the pooled accounts to pay invoices and other expenses. A number of payments were made from the BoI NI Deposit account or other pooled accounts to meet expenses of the Destiny 171 trust. [KPMG Exhibits 4-8]

(c) High Level Review

A high level review of the level of cross subsidisation of commercial/syndicated trusts from the pooled accounts is detailed below. It should again be borne in mind that the accounting entries on the UNITY system while they appear broadly accurate need to be fully reconciled. Also the analysis below refers only to the position of trusts with their own separate banking accounts versus the pooled accounts and does not incorporate situations whereby cross subsidisation may be occurring between the commercial/syndicated funds themselves or between individual trusts within the pooled accounts.

In order to perform the analysis below a snapshot was taken of the pooled account balances of those trusts (15 in total) which operated their own bank accounts as at a number of dates since August 2010. The first table looks at all those trusts with separate bank accounts and takes a snapshot on various dates of the balances a) attributable to each on all of the pooled accounts and b) their own account and totals these.

The second table is a segment of the above and looks only at those trusts which have aggregate negative balances owing to the pooled accounts.

**Table 1 Summary of selected Destiny Trust Accounts**

Accounts	09-Aug-11	31-May-11	28-Feb-11	30-Nov-10	31-Aug-10
Pooled	(5,497,511)	(5,760,571)	(5,833,338)	(5,403,029)	(4,719,138)
Non pooled	(130,413)	112,456	9,679	701,421	387,188
	<u>(5,627,924)</u>	<u>(5,648,115)</u>	<u>(5,823,659)</u>	<u>(4,701,608)</u>	<u>(4,331,949)</u>

<sup>12</sup> Destiny Client Savings (€218,914.48); BoI NI Current (€223,816.74); BoI NI Rental (€179,178.42); Destiny Property Current +€162.19

**Table 2 Summary for those with aggregate negative balances in pooled accounts.**

Accounts	09-Aug-11	31-May-11	28-Feb-11	30-Nov-10	31-Aug-10
Pooled	(6,600,787)	(6,746,552)	(6,689,180)	(6,123,045)	(5,500,248)
Non pooled	175,029	54,821	(10,892)	1,095,571	457,829
	<u>(6,425,758)</u>	<u>(6,691,732)</u>	<u>(6,700,073)</u>	<u>(5,027,474)</u>	<u>(5,042,418)</u>

As of 9th August therefore it would appear that €6,600,787 million was owed by a select number of (typically commercial/syndicated) trusts to other trusts within the Destiny structure whose cash assets were held in pooled accounts with only €175,029 held in credit on their own cash accounts. This figure is likely to be higher if account is taken of cross subsidisation between pooled trusts and between individual commercial/syndicated trusts.

The problem appears, as of 9 August 2011 to be most acute in respect of five specific commercial/syndicated UK property based trusts.

	<b>Destiny 83</b>	<b>Destiny 100</b>	<b>Destiny 171</b>	<b>Destiny 173</b>	<b>Destiny 192</b>
Pooled account	(€394,245)	(€85,955)	(€730,450)	(€3,238,854)	(€2,098,267)
Own Account	(€261,923)	€54,324	(€38,966)	€202,295	€181,007
Net Position	(€656,168)	(€31,631)	(€769,416)	(€3,036,559)	(€1,917,259)

#### 4.4 Conclusions

The Inspectors are of the view that the practice of using available cash balances on the pooled cash accounts to pay invoices and other expenses of individual sub-trusts, particularly those of the larger commercial/syndicated trusts, was pervasive within CHC for a considerable time.

Unit holders in the affected sub-trusts would not be aware that this was taking place having regard to the pooled nature of the cash accounts and the fact that in any statement issued to them by CHC their holdings in the trusts would be reflected as units held. As each trust would appear to be a separate legal entity, the problems in resolving this issue will be most acute in relation to those trusts which a) in aggregate owe money to the pooled accounts and other trusts, b) have little cash holdings in their own right and c) have poor or negative cash flows. A thorough analysis of each trust's transactions will be required.

Based on the testimony received and the forensic examination the practice would appear to have existed for some time within CHC. The scale of the problem appears to have increased to some extent in 2011.

It will take considerable effort and time to fully verify, unravel and reconcile all of the transactions which resulted from the above practices at individual trust levels.

## 5. SEGREGATED CLIENT ASSET ACCOUNTS

### 5.1 Introduction

CHC operates various client asset accounts. These individual accounts hold both investments and cash belonging to clients. Some clients' accounts have investment mandates that are discretionary, conferring asset management discretion on CHC, but many do not. A significant number of CHC's clients maintain their investment holdings directly through CHC. These clients maintain a series of investments including cash on deposit with a credit institution or held within CHC segregated accounts. The cash held with CHC could however be pooled in one of a number of designated client asset accounts – the Client Asset Current Account, Client Asset Net Account and the Client Asset Gross Savings account. Based on information obtained by the Inspectors it is clear that cash from one or more of these client accounts was improperly taken and used to fund CHC-promoted client property investments.

A full reconciliation of all of these client asset accounts will be time consuming, difficult to undertake and will likely take considerable time. Hence this has not been fully undertaken by the Inspectors and KPMG for the purpose of this Report. However, it has been represented to the Inspectors in the sworn testimony that cash in excess of €11 million may have been transferred from these accounts, in particular the Client Asset Gross Savings Account, to fund property related client investments.

The Inspectors requested that KPMG specifically review a sample of client balances held in the Segregated Client Asset Accounts and a summary of their analysis is contained in section 5.3.

### 5.2 Sworn Testimony to Inspectors

The witnesses called by the Inspectors were asked to describe the operation of the client asset accounts, comment on whether they were aware that monies were taken without clients' knowledge or consent and who authorised the transactions.

#### Testimony of Mr Paul Lavery on 19 July 2011

- Q. In terms of payments that would have gone through Client Asset accounts and then into, say, the European property, SPVs, how would those transactions have come about who? Who would have instructed the payment to be made and who would have processed it? [30:07-30:18]
- A. *The instruction would have come from Harry. He would say 'Listen, there is money to go to a specific property' and he would say 'These are the clients that this payment should be allocated to'. Then he would come back and he'd approve the payments and that payment*

would be processed on Banking on Line, if it was Banking on Line, or through the bank. [30:12-30:18]

Q. So would you process that? [30:19]

A. I would set the payment up or somebody else would authorise it, John Whyte or whoever was there would authorise the payment on his instruction. [30:20-30:22]

Q. Then the approval would come from John or Harry... [30:23-30:24]

A. Approval would only come from Harry directly. John would only approve on Banking on Line as he is the other party. You need, sorry, two approvals. So, you know, there is no investment initiated by anybody in there only Harry in relation to -- like, nobody had any investments only him. [30:25-31:01]

Q. Are you aware of any transaction packs for those? [31:02]

A. To be honest with you, a lot of them were prior to the transaction packs<sup>13</sup>, as I said earlier, were prior to the transaction coming in to play. [31:03-31:05]

Q. How would you get those instructions from Harry? [31:06-31:07]

A. Harry would send you an e-mail saying he needed to talk to you and you'd go down to him and he'd say 'Listen, there's a payment to go out to X property' and you'd say 'And? What can we do about it, like? I can't do anything about that'. He'd say 'Listen, it needs to go' and I'd say 'Where are you going to fund it from?'. He'd say 'It has to go out today, it has to be done', you know. And 'I don't know where you're going to fund it from, to be honest with you' and he says 'Well, we'll have to fund it because it has to go out. If it doesn't go out, you know, any money going across, any money that has gone across to that specific property is going to be lost'. I said 'Well, you can't do that' and he'd say 'Well, if we don't do it, we are going to lose everything'. That was always his line. When you raised concerns that you can't do this, he'd say if we don't do this, whatever equity that has been invested is going to be lost is needed is going to be lost. [31:08-31:24]<sup>14</sup>

Q. So what would happen then, what would you do then? [31:25]

A. Then he would come down and say these are client balances as of a specific date and he would pick a number of clients and allocate the payment to these<sup>15</sup> clients. [31:26-31:29]

Q. On what basis would he do that? [32:01-32:02]

A. I don't know -- unless he knew the clients, I am not too sure. I always thought it was on the basis that he knew the client and he had discretion on the client account. But, more recently, I've realised that he didn't have discretion on a lot of accounts, it was just on his... [32:03-32:07]<sup>16</sup>

Q. So he would just come around and pick them, but the instructions you got were just to meet him. He wouldn't give it to you in an e-mail 'Do the following clients'? [32:08-32:12]

A. No. [32:13]

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<sup>13</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>14</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>15</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>16</sup> Underlined text has been added to the verbatim transcript by the interviewee

- Q. So he would come at his behest and he'd say to you 'I want X, Y, Z. Do that'? [32:14-32:15/]
- A. *Correct, yes.* [32:16]
- Q. Then would you record that as normal or you would show where it was coming out from and all that? [32:17-32:18]
- A. *Yes, that's how it has come down to be reflected on the client accounts because it has to be reflected somewhere. There's supposed to be a trail of stuff. You can't not post anything. That's where it comes back to the Stockbroker Account and this investment.* [32:19-32:23]
- Q. So, as far as you are aware, the posting was correct for that particular client, so if they did have cash, then the cash was gone and it was then translated into an investment in an SPV? [32:24-32:28]
- A. *Correct, correct.* [32:29]
- Q. So it can still be located? [33:01]
- A. *Yes* [33:02]
- Q. Who would put the note on that account then? [33:03-33:04]
- A. *Well, the note on account would be put on by one of the Client Servicing team or sometimes it would be put on by Michelle. She would obviously see the payment arrive and she'd say 'These are the payments and this is how he wants it allocated'. Then in order to post, it has to be posted to the client and then identified on the clients account that there was an incorrect transaction on it.* [33:05-33:12]
- Q. So would he have to discuss that then with Michelle how he want it flagged? [33:13-33:15]
- A. *Yeah, he would have discussed with us previously how he wanted a note on the system so that it would be flagged there so when a client service team would come to do a valuation would see this note and they would review the valuation before it would go out to clients. Obviously, a lot of times, the valuation went out with an investment on it that shouldn't have been on it. In a lot of cases, that happened because, you know...* [33:16—33:23]<sup>17</sup>
- Q. Like, it was mistakenly sent out... [33:24-33:25]
- A. *Because, you know, we always assumed that the investment that Harry had chosen, that the clients, that they were legit and it was only more recently, I was just thinking about it last year, he asked me to look at an investment and I done up a schedule up and said, 'Listen, these clients, these are investments made and these are accounts that cash was used-- but, listen, these are not all discretionary', you know, that sort of a way. Then I went through client accounts myself, checked through client documentation...* [33:26-34:06]<sup>18</sup>
- Q. When did that conversation take place?[34:07]
- A. *That was last August before I went on holidays. I was trying to think about it last night. It was last August. I went on holidays in early August and I was thinking about it and he was pressurising me and pressurising me to go through and get a detailed list of clients where*

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<sup>17</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>18</sup> Underlined text has been added to the verbatim transcript by the interviewee

*investments were made and obviously I didn't have -- it was difficult for me because I didn't have -- I had to get Michelle to do work on Unity because I didn't have any access rights to Unity. She had to pull up stuff for me in the reports and she had to go through it. [34:08-34:18]*

**Further on in the testimony of Mr. Paul Lavery**

Q. If you can, please let us know. Just going back to the conversation in August, at that stage, was it not -- I suppose, were alarm bells not ringing that the accounts being chosen by Harry weren't discretionary? [35:20-35:23]

A. *Alarm bells were ringing all the time, to be honest with you. I have always raised concerns with him and, I suppose, like, the reason he said he would sort them out and he would deal with it and he would resolve the accounts, you know, and I suppose it was always in the back of my mind that I placed my trust in him and I always thought at the end of the day that he would do the correct thing and resolve the issues. But, you know, I always said, listen, give him time to resolve them, but it just kept going on and on and on. [35:24-36:04]*

Q. Did you ever raise your concerns with any of the other directors? [36:05-36:07]

A. *I spoke on a number of occasions to John Whyte about it and he had similar concerns and went to Harry about it too on numerous occasions. I suppose you don't know who to go to. You go to your main boss and you assume that he is going to resolve these issues. [36:08-36:12]*

**Testimony of Mr Harry Cassidy on 19 July 2011**

Q. Just to go back to the other question then, Harry, if I could, essentially, were there funds taken from any other cash or equity or other type of investment to fund some of the shortfalls? [22:18-22:22]

A. *Well, I think...(INTERJECTION) [22:23]*

Q. That you are aware of? [22:24]

A. *Well, when the letter came in from Appian and I looked at the questions that they had raised -- I think there were five questions in all -- I was somewhat shocked by the reference to the -- what do you call them -- the segregated clients. I think it's Question 3 they raise and they give an example of three clients, and two of those clients I very definitely understood that they were still in cash because I had asked it several times myself. [22:25-23:04]*

Q. Do you recall the names of those two people? [23:05-23:06]

A. *Yes, CLIENT 22 and -- I would have to look at the letter and see... [23:07-23:08]*

Q. From my recollection, there was a CLIENT 2 in there, was there? [23:09-23:10]

A. *Sorry, CLIENT 2, yes, CLIENT 2 was the second one and CLIENT 23 was the third one. But, CLIENT 23, I don't know that client at all. I know CLIENT 2 and I know CLIENT 22 personally. So I was surprised that they were in properties because I had been very definitely told on a number of occasions that they weren't. CLIENT 22 's money is reflected as being in Quiff 2 and CLIENT 2's was shown as being invested in Parkstadt, I think, but both of them were supposed to be in cash. I have no hesitation in holding my hands up in relation to, as I have just said, about the Destiny equity. But in terms of the private clients, those that I thought still should have been in cash, I am surprised that they were. So on the Friday when I got -- I got the letter about six o'clock delivered to the office and I spent six or seven hours there that night going through what I could with the help of Paul because I don't have access*

to the system so, like, I wouldn't know how to get into Unity. I don't have a password so I needed somebody to show me just to get an idea as to what else was there because, obviously, the question that Appian had raised was only in relation to three clients so I needed to have a look at that. Then, over the weekend, Saturday and Sunday, both Liam O'Reilly and Graham O'Reilly, I asked them could they come and help me because I needed to get to the bottom of it and they very kindly donated their weekend, and a lot of it, (a) because I needed to see could I get answers to Appian's questions, but also to try and identify the problems. It became very evident from at the end of Saturday into Sunday that there were obviously more than the three examples and there was a couple of names that popped up that, again, I was more than surprised at. Then, as I say, the rest is somewhat history now. [23:11-24:15]

Q. The ones that you wouldn't have been aware of and that you would have the understanding that the client holding was still in cash, was there any evidence of how the transaction did actually get processed whereby it converted into a property holding? [24:16-24:20]

A. Well, I don't have the information as to how it did that. All I did was, and I was very clear with Graham and Liam, is when we looked at it -- not that they would, but I said 'Look, what I need to find out is what is behind this, but I don't need you to change anything. I need you to identify where there are errors and make comments on a spreadsheet', so they dropped everything into spreadsheets and have made comments and they have copied that to both HBC and to KPMG. So I wasn't really interested in so much as to how was it being done, just to try and identify a quantum. [24:21-25:03]

Q. The amounts and the affected clients? [25:04]

A. Yes. [25:05]

Q. So are you saying that that was done without your permission? [25:06-25:08]

A. Well, I didn't authorise money to be transferred out of CLIENT 22. I didn't authorise money to be transferred out of CLIENT 2 and I can go through the list and I suspect the vast majority of those either -- well, call them segregated clients -- some could be discretionary, some would be advisory -- I wouldn't have given authorisation to that at all. [25:09-25:15]

Q. And who did? [25:16]

A. Well, that is a question you would have to ask somebody else because I don't know. [25:17-25:18]

Q. You haven't tried to find out? [25:19]

A. As I said, I have been trying more -- well, not in the last couple of days because it's out of my hands now, but in the time I had over the weekend to try to respond to the Appian letter, I was more concerned with trying to get a quantum as to how many clients were impacted and how many clients of those, how many were discretionary and how many were non-discretionary. [25:20-25:26]

Q. Since these amounts were going to plug holes in the property transactions essentially in this case... [25:27-26:1]

...

Q. They weren't going to pay normal bills... [26:03]



- A. *No, no, everything that's -- I suppose, if there is one bright light in it, that's I haven't seen any evidence that anything was -- any fraud or misappropriation. You know, that it has been to, as you say, to plug holes in property portfolios. [26:04-26:08]*
- Q. I presume then the instruction to fill the hole, if not from Account A, B and C, but to fill the hole would have come from probably yourself? [26:09-26:11]
- A. *Well, that's putting words in my mouth, George, because I think our system is probably weak in that it didn't actually need my authorisation to do it because I didn't authorise all of those payments. So those payments could have been made without my knowledge. That's not to say I didn't know there was a hole obviously in the property, which I did, but I didn't specifically authorise, whether that be John or Paul or anybody else, to say go to CLIENT 22 portfolio and take 400,000 for that and put it into this. I just simply didn't do it. [26:12-26:22]*
- Q. Was there any instances in those accounts that have come up with those kind of issues attached to them that you did authorise any instructions on? [26:23-26:26]
- A. *Well, the vast majority of them, I actually don't know at all. I would know CLIENT 2 and I would know CLIENT 22 because I know them personally and one other client I know personally. There was a number of others who are in a sort of category 25 or 30,000 and I'd say the vast majority of those I don't even know and I don't even think I've ever met them. [26:27-27:04]*
- Q. But not even not knowing them, but the instruction... [27:05-27:06]
- A. *Again, I have checked my e-mails and I can't find any records of that to the best of my knowledge this is position<sup>19</sup>. [27:07-27:08]*

**Further on in the testimony of Mr. Harry Cassidy**

- Q. But would there be another place within the firm obviously that would record how it got there and who instructed the money to go to there? [28:23-28:25]
- A. *That would normally be Paul and John because that's --you know, any client transactions came out of John's area. Any money transfers came out of Paul's area because that's what he did and that was one of his job functions. [28:26-29:01]*

**Further on in the testimony of Mr. Harry Cassidy**

- Q. Now, I am just going to touch, Harry, on the regulated MiFID Client Asset accounts that would be subject, obviously, to the audit by your auditors, MKO. Again, there seems to be or appears to be issues arising whereby transactions were issued over those accounts and it may touch back on some of the issues we talked about earlier on the segregated client accounts like the CLIENT 22 situation whereby transactions seem to have been processed through those accounts, again not with the knowledge of the client in question, and they were going back to the whole client statement situation? [25:20-59:02]

.....

- Q. Who has the authority, I suppose, maybe, firstly, just to clarify for processing and issuing transactions on those accounts? [59:03]

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<sup>19</sup> Text underlined has been amended from the verbatim transcript by the interviewee

- A. *On just the CLIENT 22? [59:07]*
- Q. *Well, on the designated Client Asset accounts? [59:08]*
- A. *Well, the people who would be responsible for that would be the people working in the Client Servicing area, which would be John Whyte and his team and, predominantly, it would be them. So we try to simplify things so that all client issues are dealt with by John and whoever reports to John and they would have upward line reporting to him to approve purchases. John would normally -- well, when we had other people working with him there on the equity side, they would be dealing with, say, Merrion Stockbrokers for purchasing stocks, so they would be checked by John. So when Sean was there or Owen or whoever would be putting a transaction through, there would be a checking process and when the contract note came back in, that would be checked to make sure that our records compared with Merrion's records so there would be no errors made. So they were the main people that would have responsibility for that. Then if there was cash moving, that would be processed then normally through Paul's team, so that's on the client's side, so that if there was money transferring to Merrion or into the Destiny property fund or whatever it was, that it would go through that process. It didn't come by me because I didn't need to authorise it because they were dealing with it. We would have meetings on a weekly basis just to discuss client issues or problems with Merrion or whatever that might be, but that's when it would come to my attention. [59:09-60:07]*
- Q. *Did you have any signing authority on those accounts? [60:08]*
- A. *Me, personally? [60:09]*
- Q. *Yeah? [60:10]*
- A. *No, I didn't transact, I never transact because I didn't get involved day to day because it would take up too much of my time. If a client wanted to do a transaction, say, with Merrion, I would pass it to John or pass it to one of his team. So, say, CLIENT 24, who is a good example, normally they would deal with me until such time as they were comfortable with dealing with somebody else, so CLIENT 24 and I go back 30 years so, eventually, got him weaned off me so that he could deal with John. So if he rang me and said 'Okay, Harry, look, I want to buy Bank of Ireland' or 'I want to do this' or whatever, I would pass him on to John or take the instruction and pass it over to John to get it done. So eventually then John would be dealing with him and he would have direct access to John so they would done do the transaction, so I would do none of that. [60:11-60:27]*
- Q. *Again, just to be clear, did you actually have the authority to process transactions on this? [60:28-60:29]*
- A. *I am sure I have, but I have never used it. [61:01]*
- ....
- A. *I was told over the weekend because Leslie and Sean were trying to identify who had, say, access to the M drive and I was told I had it, but I have never actually used it. So I may well have it and I am not aware of it, you know, but I have not used it. [61:03-61:07]*
- Q. *Did you ever ask anybody else, even though you may not have processed a transaction yourself, did you ever ask anybody else to process the transaction with their authority? [61:08-61:11]*
- A. *Well, obviously if I had asked John to buy shares for CLIENT 24 or to buy something else, yes, I would have obviously asked him to do that. [61:12-61:14]*

- Q. Would there be a record of that, would there be a written record anywhere? [61:15-61:16]
- A. *Well, there should be e-mails to say, you know, CLIENT 24 wants to buy X. I say a good example would be SolarPrint that we invested in recently. So a couple of people, including CLIENT 25, wanted to put some money in. So, CLIENT 25 wanted to sell her CRH shares-- I think it was CRH or Ryanair or whatever -- so I would have sent an e-mail to John to say 'CLIENT 25 wants to sell CRH; can you sell those at best price?'. And when the cash came in, you know 'CLIENT 25 wants to put this into SolarPrint'. So, typically, we would do that by e-mail because, as you know, I spend a lot of time away. So one of the reasons why I didn't have this authority is because there's no point in waiting for me to come back because I could be gone for two or three days. So I think it just transformed into that way. It wasn't set out to do, but just with a lot of travel, authority was left to John and others to carry out transactions specific to the clients. So I would have, you know, more say and control, if you like, in relation to the property aspects but not in relation to other assets because I didn't have the detailed knowledge in the client accounts.[61:17-62:09]*

#### **Testimony of Ms Ciara Kelleher on 22 July 2011**

- Q. So if somebody moved the cash from that account into a property, there should have been a transaction pack? [46:23-46:24]
- A. *Yeah, but, I mean, there couldn't have been because you would have to have the client's authorisation and the transaction pack I did for that account was to move his account to cash to get a better interest rate in Merrion. That compliance pack, I submitted personally, got approval personally and sent to Fund Admin personally and have chased personally since then, to the point that when Harry met CLIENT 2 in the airport and told John 'Oh, I met CLIENT 2, he's fine', I said to John 'He's fine because he thinks his funds have moved to Merrion. Like, what's anybody doing?' They just ignore it<sup>20</sup>. [46:25-47:06]<sup>21</sup>*
- Q. But if we are to look back on this and find the fact that CLIENT 2's cash wasn't either in the Bank of Ireland account or, indeed, in Merrion and was, indeed, in the Munich Parkstadt, a transaction pack should have been done and possibly wasn't. Would that be the situation? [47:07-47:12]
- A. *I don't think it could have been done because it can't have been done without the client's authorisation. So you can bet your bottom dollar that it wasn't done because the transaction pack would have to be valid. [47:13-47:16]<sup>22</sup>*
- Q. The transaction pack wasn't done or that the... [47:17-47:18]
- A. *The transaction pack couldn't have been done because you would need -- the start of a transaction pack is the client's request to do something. [47:19-47:21]*
- Q. Yeah? [47:22]
- A. *So CLIENT 2 would never have asked for that, so there couldn't have been a transaction pack. That is 100% certain. There could not have been a transaction pack because the transaction pack was my transaction pack, which was to get a better interest rate for the man. [47:23-47:27]*

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<sup>20</sup> Mr Whyte disputes that he ignored such matters. Having regard to the considerations outlined at paragraph 1.13 above, the inspectors have been unable to form any conclusion on this.

<sup>21</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>22</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

### Testimony of Mr John Whyte on 25 July 2011

- Q. I am not expecting you to have specifics on it but for the earlier ones, the client level and the PRSA cash fund, so what amounts were we talking prior to quarter four 2010? [6:23 – 6:26]
- A. *On the PRSA cash fund you could have been looking at a figure of between 10 and 11 million. On the client asset accounts, George, you may be looking up at anywhere of a figure between 12 and 15 million approximately. I wouldn't have the exact figure.* [6:27 – 7:2]

### Further on in the testimony of Mr John Whyte

- Q. Can I just, sorry can I just ask one further issues on the shortfalls and on specifically the client side, where you mentioned John there was maybe 12 to 15 million involved? In respect of those transactions that were processed for those particular clients can you, do you know how those transactions came about or who processed them or -- [20:22-20:29]
- A. *Well first of all, Noel, let's take a step back. Like Harry would identify where he has a hole to fill in terms of property gaps. There was no, there was no specific selection process of which client accounts were used, it was a random selection of client accounts.* [21:01-21:06]
- Q. Who would do that random selection? [21:07-21:08]
- A. *Well it would be ultimately Harry that would decide but like if you asked me, for example, could you list the 50/60 clients I actually couldn't tell you who the 50 or 60 clients are because it was random selection. But again that would happen, George, over a period of time because it did not all happen in one...* [21:09-21:14]
- Q. Batch. [21:15]
- A. *....batch because there was holes over a period of, and this is going back to my earlier point, over a period of maybe three to four years. So it would...* [21:16-21:18]
- Q. Even on the same investment, even on the same SPV? [21:20-21:22]
- A. *I don't think so. I think there would be different SPVs at different intervals.* [21:23-21:24]
- Q. Okay. [21:25]
- A. *So if you ask me, for example, from the very first hole to fill to the very last is there an overlap of SPVs, there could very well be between the first to the last, but like generally it was you know filling a Munich Parkstadt or some property, for example, filling that on day one, I need to fill this gap.* [21:26-22:02]
- Q. Okay. [22:03]
- A. *And then he would come. So there was no, no selection process, it was a random selection of clients. Then once they were identified then the monies were transferred out in the specific SPV.* [22:04-22:07]
- Q. I assume when you say "random selection" it was obviously somewhat focused on those ones that had excess cash sitting there? [22:08-22:11]

- A. *What I would say, Noel, it was primarily on pension funds because pension funds are, you are looking at long term investments as opposed to, for example, a private account. [22:12-22:15]*
- Q. Okay. When a particular client or group of clients were identified what would happen then in terms of processing the transactions on those customer accounts; who would authorise them, who would process them and send the money onto the SPVs? [22:16-22:20]
- A. *Well ultimately like the, it is ultimately anything goes through finance in terms of the payments out to the SPVs but that would be under authorisation from Harry Cassidy to make those payments out, and they would be approved by Harry Cassidy. So I can genuinely say that any payments on the client asset accounts over a period of time would require Harry's approval. Now that is maybe in the form of e-mail. Harry does not have the banking online access to actually push the button to transfer the monies, but it would be ultimately his authorisation approval to make those payments into whatever SPV that he needed to fill the hole in. [22:21-23:04]*
- Q. Somebody then in the Finance Department would actually authorise them on line? [23:05-23:06]
- A. Yes. [23:07]
- Q. Or do.. [23:08]
- A. *And it would require my, like there is an input and authorisation mode in terms of, so there would be one person who would put the input in and then somebody who would authorise that at the administrative level. [23:09-23:12]*
- Q. Okay. Did you ever authorise any of these transactions? [23:13]
- A. *I may have, Noel, I may have under Harry's instruction, absolutely. [23:14-23:15]*
- Q. I suppose in relation to that Paul Lavery is the head of the finance function? [23:16-23:18]
- A. Yes. [23:19]
- Q. And in your knowledge would Paul have acted without either your or Harry's instruction to move monies out of - [23:20-23:22]
- A. *Well just, because I know you are saying some very -- like any instructions for these movements was on Harry Cassidy's instruction, Harry Cassidy's instruction only. Paul Lavery would not have moved any of those monies without Harry Cassidy's authorisation or instruction to do that, absolutely not. He would not have done that on his own accord nor would he have taken instructions from me. [23:23-24:01]*
- Q. Right? [24:02]
- A. *It was from Harry Cassidy and Harry Cassidy alone, George [24:03-24:04]*

### **Further on in the testimony of Mr. John Whyte**

- A. *Well I did but it was going back to Harry to find out. Like my concern was, was to manage expectations that properties were being sold so that CHC<sup>23</sup> could return the money to clients. [40:21-40:24]*
- Q. Expectations to clients? [40:25]
- A. *Well exactly. [40:26]*
- Q. Yes. [40:27]
- A. *I had to get, I had to get over a period of time, because all I was being told was "properties are being sold, properties are being sold to return these monies to clients", I never got any definitive time frame, what properties were in the process of being sold, how to manage those expectations when those monies came back? [40:28-41:05]*
- Q. Can I ask you were any of the clients, in your knowledge, that had been flagged ever, did they ever fall off that list? [41:06-41:09]
- A. *The only way they would fall off the list, George, is if there was a client who looked for a cash call. [41:10-41:11]*
- Q. Right. [41:12]
- A. *So therefore then another client's money would have been used to replace. [41:13-41:14]*

### **Signed Statement of Mr. John Whyte- 17 July 2011**

#### **Client Asset Accounts - paragraphs 10 to 21**

10. CHC operates over 2000 client asset accounts. These accounts hold both investments and cash belonging to clients. Some client asset accounts have mandates that are discretionary, other are advisory or execution only.
11. There were up to 54 client asset accounts at CHC that were assigned as being "blocked accounts". This means that contact had to be made with the Finance Department in order for valuations to be run.
12. There was a practice at CHC where cash held by CHC in client accounts was, on occasion, being used, unknown to the relevant clients, to fund property investments. This was done on the instructions of Harry Cassidy. So, for example, where a client entrusted €100,000 to CHC, €50,000 allocated to shares and €50,000 allocated to cash, the cash may have been used by Harry Cassidy to invest in a property deal.
13. The client would not have been aware of this. The transaction would have been recorded on the CHC system as a property valuation, however, when the client statement of account would be issued to a client, the entry would have been reversed in advance on the system so that the client would see it as recording a cash position.
14. The valuations reflected on the cash accounts were designated as "Stockbroker Capital Accounts" or "Client Cash Accounts". The property investments were only shown on such accounts outside of the report dates. The Stockbroker Capital

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<sup>23</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

Account or Client Cash Account was shown on the statement that was issued to the client on the report date.

15. These postings were carried out by the Finance Department at CHC and all valuations would have been run by the Client Services Area in relation to these valuations.
16. For the relevant "blocked" accounts, as I mentioned at paragraph 11 above, an employee in Client Service would have had to contact the Finance Department before the valuations could be run. So when a Client Services person, or indeed anybody in CHC, would look up an account and see it flagged as "Please contact Harry or Paul before running valuation", they would have to ask the Finance Department for that investment to be backed out before the valuation was run and sent to the client.
17. These monies were allocated to various properties by the investment into SPVs for the specific property structures.
18. There is a money trail by virtue of which the specific investments can be identified. To the best of my knowledge, no client money was taken out of the system for the direct enrichment of anyone at CHC. Rather, the money was re-allocated to property investments of anyone at CHC.
19. There was no method to the selection of which clients' money was to be used in this manner. Client accounts were randomly selected.
20. This happened over a period of time but would not have occurred after the directions letter received by CHC from the Central Bank in June 2010 relating to the use of client monies and any transactions on any client accounts.
21. I challenged Harry Cassidy on a number of occasions verbally, asking for reassurances as to when these monies would be returned to client accounts. Harry Cassidy gave me assurances that the properties were in the process of being sold and those monies would be returned but there was no timeframe given to me by him as to when those monies would be returned to the client accounts.

#### **Testimony of Mr Sean O'Dwyer on 8 August 2011**

- A. *The letter from Appian was the first that I had any idea something like this was going on and it was Monday morning, I suppose, before I had any sense of the scale of it in terms of Harry would have said 45 to 50 clients, possibly, and, again, no -- you know, I suppose, the important thing for us on the Monday, or for me anyway on the Monday morning -- and Maurice would have attended that Board meeting as well -- was (a) the extent of it, both in terms of quantum of money and number of clients, but, equally important, getting some sort of external validation of it because, clearly, as I have said, I had lost confidence in anything coming from Harry and John Whyte and Paul Lavery because that's who seemed to have been involved in it. [8:01-8:15]*

#### **Further on in the testimony of Mr. Sean O'Dwyer**

- A. *Well, look, the other thing that kind of concerned me was I had been for certainly most of 2010 doing the cash flow together with client asset or as I understand were client asset reconciliations and I now think to myself was I being fed, you know, just fantasy numbers. Now, again, I need to find out obviously exactly what numbers I was being given, but I*

*believed I was being given client asset reconciliations of the three main pooled accounts. [12:28-13:07]*

Q. Yes? [13:08]

A. *It would now appear that some of those monies had been used for property, so, therefore, the numbers... [13:09-13:11]*

Q. When you say the three main pooled accounts, which...[13:12-13:13]

A. *There was a gross account... [13:14]*

Q. Gross savings, yes? [13:15]

A. *Yes, and a net account and I forget the third one... [13:16-13:17]*

Q. Current account, was it? [13:18]

A. *Yes, current account. So two for the kind of tax pension fund accounts and then one for the gross, you know, the people who were liable to tax. But three sets of pooled accounts, you know, here's what the clients have and their piece of it. You know, the Appian letter contradicts that or it will cast serious question marks over it. So, again, I don't know was I being fed fantasy numbers that were being made up or how that was being done, but again that is something that we need to bottom out with the help of HBC. So I was being given numbers which I thought were valid, they were being reconciled. Again, I believe Suzanna and Anne were happy they were being reconciled but, you know, what was being reconciled now maybe is the question. [13:19-14:04]*

### 5.3 Forensic Examination carried out by KPMG

CHC operates three main client asset accounts:

- Client Asset Current Account - €484,893 at 11 July 2011
- Client Asset Net Account - €493,548 at 11 July 2011
- Client Asset Gross Account - €5,371,983 at 11 July 2011

#### Summary of client asset accounts as of July 2011

	Balance on No of client	Lowest client	Highest Client
	account 11 July balances	Balance	Balance
	2011		
	€	€	€
Client Asset Current Account - XXXXXXXX	484,893.38	110.63	277,456.52
Client Asset Net Account - XXXXXXXX	493,548.55	0.01	86,720.45
Client Asset Gross Account - XXXXXXXX	5,371,983.15	0.01	648,547.47



A sample of 20 clients were reviewed by KPMG to ascertain whether there were any variations between the valuation statements issued to clients and the balances maintained on the CHC Unity system in the nominal ledger. Of the 20 clients selected, 18 had balances on the Client Asset Gross Account. For all 18 such clients, the amount included on the valuation statement was higher than the amount included on the nominal ledger. The outcome of this review of 20 sample clients is set out in the table below:

### Sample of client balances reviewed

Account Name	A/C Ref	Last Valuation Date	Client Asset Gross Savings A/C	Client Asset Gross Savings A/C	Variance
			per Client Statement	per Nominal Ledger	
			€	€	€
CLIENT 26 PPT	-	30/11/2010	25,001.00	1.00	(25,000)
CLIENT 27 PPT	-	30/06/2011	25,001.85	1.85	(25,000)
CLIENT 28 PPT	-	29/04/2011	24,026.48	26.48	(24,000)
CLIENT 15 PPT	-	31/05/2011	-	-	-
CLIENT 29 ARF	-	31/03/2011	66,000.36	0.36	(66,000)
CLIENT 30 ARF	-	25/05/2011	37,166.94	17,166.94	(20,000)
CLIENT 31 ARF	-	31/12/2010	78,343.01	343.01	(78,000)
CLIENT 32 ARF	-	29/04/2011	125,036.87	36.87	(125,000)
CLIENT 2 ARF	-	31/12/2010	236,018.77	41,018.77	(195,000)
CLIENT 22 ARF	-	08/04/2011	431,550.39	1,550.39	(430,000)
CLIENT 33 PPT	-	31/01/2011	26,115.33	1,115.33	(25,000)
CLIENT 34 PRSA	-		-	-	-
CLIENT 35 SSAP	-	31/03/2011	18,952.83	452.83	(18,500)
CLIENT 36 ARF	-	10/03/2011	18,352.17	352.17	(18,000)
CLIENT 37 PPT	-	21/09/2010	23,234.71	234.71	(23,000)
CLIENT 38 PPT	-	31/03/2011	22,978.58	978.58	(22,000)
CLIENT 10 ARF	-	06/12/2010	175,387.22	3,387.22	(172,000)
CLIENT 39 PPT	-	31/05/2011	9,607.11	0.89	(9,606)
CLIENT 19 PPT	-	29/10/2010	14,725.20	4,725.20	(10,000)
CLIENT 23 PPT	-	31/05/2011	60,204.04	5,204.04	(55,000)
			1,417,702.86	76,596.64	(1,341,106)

Account Name	A/C Ref	Last Valuation Date	Client Asset Gross Savings A/C per Client Statement	Client Asset Gross Savings A/C per Nominal Ledger	Variance

To demonstrate the above, a review of the valuation statement and the nominal print for some of the above mentioned clients was conducted and set out below are the sample results from that review:

- CLIENT 26 – the latest valuation on the CHC System ‘Therefore’ is dated 30 November 2010 and indicates that the balance on the Client Asset Gross Account is €25,001. The nominal print on Unity for CLIENT 26 indicates the balance on the Client Asset Gross Savings account at that date was €1. An amount of €25,000 was transferred to the Stockbroker Capital Account on 23 August 2009 (a Sunday). CHC’s own records indicate that CLIENT 26 is an advisory only client.
- An email was identified relating to a payment out of the Client Asset Gross Bank account on 24 August 2009 for €25,000 in relation to commission due to Harry Cassidy and John Mulholland paid to a bank account name H Cassidy / J Mulholland in Luxembourg. (see Section C17 of the Report for further information in relation to this issue)
- CLIENT 22 – the latest valuation on ‘Therefore’ is dated 8 April 2011 and indicates that €431,550.39 is held in the Client Asset Gross Account. The nominal print on Unity for CLIENT 22 at that date indicates the balance actually held is €1,550.39. An amount of €430,000 is listed as invested in CHC InCenterLandsberg on 23 July 2009. This was not reflected on the statement issued to CLIENT 22.
- CLIENT 29 – the latest valuation on ‘Therefore’ is dated 31 March 2011 and indicates that the balance on the Client Asset Gross Account is €66,000.36. The nominal print on Unity for CLIENT 29 at this date indicates a balance of €0.36. The transactions on this account indicate that CLIENT 29 invested the following on 22 June 2009:

Bought CHC Schleswig Retail Fund	€55,459.98
Bought CHC Schleswig Retail Fund	€1,050 (total €56,509.98)
Bought CHC Jutland Retail Fund	€9,490.02

These amounts correspond to amounts paid to Berendes Partners in respect of the Schleswig and Jutland funds on 22 June 2009.

- CLIENT 31 – An email from Michelle Donnelly to Harry Cassidy on 17 August 2010 states *‘The 78k is sitting on stockbroker. It should be on gross savings but is one of the clients we used funds to cover other expenses so is not readily available to use cash’*.

Of the above 20 client balances, email requests exist regarding the backing out of entries and interest accruals for 18 of these clients [Inspectors Exhibit 3]. In all cases, the email has been issued to one or both of Paul Lavery and Michelle Donnelly, and the terms used included “can you do the magic”, “money on stockbroker” and “can you please back out”.

- CLIENT 15 PPT - There was no discrepancy between the Client Asset Gross Savings account as at the date of the last valuation statement saved to ‘Therefore’, and the nominal ledger in respect of CLIENT 15 PPT. However, other discrepancies were identified on this account. A review of the nominal ledger for the Client Asset Gross Savings account indicates that CLIENT 15 PPT bought an investment of €85,000 in CHC InCentreLandsberg on 23 July 2009. A detailed summary of email correspondence within CHC relating to this investment for CLIENT 15 PPT is contained in the KPMG report attached. [KPMG Exhibit 22]

The latest valuation statement held on ‘Therefore’ was dated 31 May 2011 and refers to the sale of €35,000 from the CHC InCentreLandsberg Fund on 14 December 2010, when the valuation issued to the client on 3 November 2010 did not include any such investment.

In respect of CLIENT 15 PPT, it appears that:

- This client’s funds were noted as invested in CHC InCentreLandsberg on 23 July 2009.
- The client does not appear to have been aware of this, but may have become aware in March 2010, when Mr Sean Kenzie raised the issue with Paul Lavery and Michelle Donnelly, stating that the funds should be in Destiny Equity instead.
- A valuation statement was issued to the client in error in August 2010 showing the investment in CHC InCentreLandsberg. The client queried this.
- An email from Ms Michelle Donnelly dated 17 August 2010 to Harry Cassidy states *‘The only problem with doing it is that I would foresee is that compliance will ask where we are getting the money from to repay the client his investment in landsberg seeing as the fund didn’t go ahead and we have not gotten the money back on it’* and the reply from Harry Cassidy states *‘Lets*

*sleep on it this guy will follow this through so we need to get it right..can we say it was in Grenoble not landsberg?’*

- Subsequent to this in December 2010 the client sought the transfer of all cash and Merrion balances to an external account, and funds in the Destiny Equity bank account were used for this transfer.

During the review of emails relating to CLIENT 15 PPT, the following email chain was also discovered.

- An email chain dated 9 June 2009 between Harry Cassidy and Paul Lavery [KPMG Exhibit 27]:

*“Paul for your eyes only.*

*Can you put together a list of people where we temporarily transferred funds to various properties subject to raising other monies. I need to look at where we are with those”*

Paul Lavery responded:

*The below details to date where we have taken funds over the last few months to cover property payments:*

<i>(CLIENT 9) PRSA</i>	<i>€1,294,000</i>
<i>(CLIENT 40) PRSA</i>	<i>€1,540,622</i>
<i>(CLIENT 4) ARF</i>	<i>€362,622</i>

Harry Cassidy responded:

*“Is that all? What about (CLIENT 41) and (CLIENT 42)? I am sure there were others? I need full list”*

Paul Lavery then stated:

*“I will review and update list.*

*There is €578,570 in to date on Grenoble. We will have to review cash lists first thing tomorrow to see if we can use funds temporarily.*

The following emails relating to these issues were also identified by KPMG in their analysis: [KPMG Exhibit 21]

- An email chain dated 17 August 2010 between Harry Cassidy and Michelle Donnelly

*“Harry*

*The 78k is sitting on stockbroker. It should be on gross savings but is one of the clients we used funds to cover other expenses so is no readily available to use in cash”*

Harry Cassidy responded

*“How many more of these are there? This guy will be wanting to make a deposit on a property some time soon approx. 10k deposit followed by a payment of 35k initially”*

Michelle Donnelly responded

*“These should be all part of the list of funds used that paul gave you before he left. In total circa 16.6m.instead of funds being in a property its just on stockbroker.*

*I can forward this to you again if you need it?*

*These will have to be refunded out of cash expected from the sale of property”*

Harry Cassidy responded

*“No I have the list..ok will talk to you tomorrow on this.. need to focus on CLIENT 15 I think for now..”*

- An email chain dated 21 June 2009 between Paul Lavery and Harry Cassidy (in relation to CLIENT 31 ARF). [KPMG Exhibit 25]

*“Harry*

*We took the following from Client Asset Gross Account*

*-CLIENT 42 €660,000*

*- CLIENT 41 €918,000*

*Total €1578,000*

*I have attached a breakdown of the client asset gross account from 60k balances onwards:*

*[There followed a list of 25 clients with balances between €61,698.26 and €433,906.97]*

*I have highlighted the ones which we could apportion funds over. Can you review.*

*Do you think it would be possible to reduce the amount we have to transfer out.”*

Harry Cassidy responded

*"I do not think we can reduce it as they want to transfer funds asap. Will you talk to John Mulholland.*

*Where are deidre and Daniel on loan.*

*What about CLIENT 43's funds?"*

#### **5.4 Conclusions**

In the view of the Inspectors, cash held by CHC on behalf of clients was invested in various CHC property funds without their knowledge or consent and contrary to mandates given by clients. There was a systemic and widespread practice within CHC of concealing this in the valuation statements issued to relevant clients. Valuation statements issued to relevant clients showed the full amount of cash that was supposed to be held for clients in the segregated client asset accounts in line with the clients' expectations and instructions.

This practice was facilitated by the backing out of real transactions (transferring cash to property funds) that had taken place and fictitious cash holdings being substituted in their place. This appears to have occurred regularly on clients' cash accounts. In some instances where valuation statements were issued to clients and the backing out of transactions did not take place the clients raised queries with CHC. This led to further instances of backing out real transactions and replacing them with fictitious cash transactions to show a misleading cash position on client statements.

Within CHC this practice was managed and facilitated by the use of a flag system on CHC's internal systems whereby client accounts where such unauthorised transactions took place were flagged as "Please contact Harry or Paul before running this valuation." Further details are set out in Part B12.

It is also clear that a practice existed whereby money being held by CHC on behalf of specific clients was taken and used to fund shortfalls arising on CHC property funds. In circumstances where a request for cash from a client was received and that money had already been placed in a CHC property fund without his or her knowledge, the request to repay the cash was facilitated by taking money from other client cash accounts.

## 6. CAPITAL PROTECTED COMMODITY BONDS, AND USE OF FUNDS IN MIDDLE EAST DEPOSIT ARRANGEMENT

### 6.1 Introduction

Mr John Whyte, Executive Director of CHC, requested a meeting with the Central Bank on 11 July 2011. He was accompanied by his solicitor and gave the Bank a voluntary oral statement. This was subsequently followed by a written statement from Mr Whyte which was submitted to the Central Bank dated 17 July 2011. As part of this voluntary written statement Mr Whyte stated:

*'Another Potential Issue*

*37. There may also be an issue in relation to capital protected bonds on behalf of clients dating back four to five years. Rather than being invested in a capital protected bonds, I understand these monies are now in German bank deposit accounts. It may be that these deposits are cash-backed against property but I cannot say for certain. I do know that the deposits fall under the German deposit guarantee scheme and, as such, are afforded some degree of protection.'*

In 2005 CHC invited clients to invest in 2 'Capital Protected Commodity Bonds'. 20 clients invested a total of €3,514,535 in the two bonds [KPMG Exhibits 80 and 81] both of which were arranged through Barclays Capital in London. These bonds appear to have had a locked in return of 1.527 and 1.426 on maturity respectively. A further 'Capital Protected Commodity Deposit' was arranged in June 2006. This attracted 31 clients and €2,319,000 in subscriptions [KPMG Exhibit 82]. This 'deposit' did not appear to have a locked-in return. Barclays Capital dealt at all times with CHC, with the bonds being held in the name of CHC and not the individual clients.

The total amount of capital invested by the 51 clients in the three bonds listed above was €5,833,535. After one client withdrew from the bond and another partially encashed their investment, the amount invested stood at €5,533,535 [KPMG Exhibit 83]. In November 2009 these bonds were sold or a redemption arranged with Barclays by CHC. The email traffic and CHC records suggest that the redemption proceeds from the three bonds amounted to €7,366,016.03 [KPMG Exhibit 90].

Mr Cassidy stated to the Inspectors that he had taken the decision to encash certain capital protected bonds held on behalf of clients although he had discussed the transaction with another director of CHC (John Whyte). He further stated that rather than repay the proceeds (which he recalled amounted to approximately €7.7 million) to clients, the money was placed on fixed term deposit in a back-to-back collateral arrangement with a German private bank

called Hauck & Aufhäuser. This bank then advanced a loan to CHC amounting to in excess of €7 million using the fixed term deposit as collateral. The proceeds of this loan were used to fund the CHC Allemanic Fund which was at the time investing in a number of shopping centres in Germany. Subsequent investigations suggest that some proceeds may also have been invested in the CHC Munich Parkstadt property fund.

The inspectors requested that KPMG specifically review this issue and their analysis is summarised below in section 6.3.

## 6.2 Sworn Testimony to Inspectors

The witnesses called by the Inspectors were asked to identify circumstances where assets of clients were used to collateralise borrowings used to finance the client property investments and more specifically to identify the circumstances under which structured bond products in which clients had invested may have been sold without clients' knowledge.

The following statements, including questions where relevant, are taken from those sworn witness statements:

### Mr Harry Cassidy on 19 July 2011

Q. Are you aware or have you authorised the use of client assets or deposits in bank accounts for held-for clients to be used as security or collateral against any of those loans those banks might have been providing to the SPVs? [49:20 – 49:24]

A. *There is one. It is -- let me just get the name of it right because it is always confusing -- it is Hauck & Aufhäuser, a German bank. They're a private bank. We have a back-to-back facility with that bank. The total is again, it's either 7.6 or 7.8 million. I might be slightly out on that.* [49:25 – 50:01]

...

A. *We needed to complete on a property known as Alliamanic* [50:12]

...

A. *It's a retail portfolio in northern Germany. It consists of five portfolios, small shopping centres.* [50:17 – 50:18]

...

A. *And the senior bank lender to that property is the Valovis Bank. So we were looking to see could we again bridge the equity that we hadn't raised...* [50:20 – 50:22]

...

A. *So we needed to bridge the gap and we needed to find a bank that would do that and this German bank was introduced to us, obviously in Germany. They are based in Hamburg. They*



*are a private bank and they asked us if there is some asset that we could provide and we have a portfolio that was with Barclays Capital -- it was a structured product. So we transferred the deposit from that into Hauck & Aufhäuser and they gave us a back-to-back facility, as I said, circa 80% and then that cash was then put into the Alliamanic and, when the property is sold, we will repay the bank and then they will repay us the deposit. [51: 08 – 51:19]*

Q. Can I just ask then in relation to the Barclays Capital structured product, clients -- well, maybe you can just explain how clients were invested in that? [51:20-51:22]

A. *Well, it was one of these typically structured derivative products that we would have structured every now and again. They were quite attractive a few years ago when interest rates were higher than they are now because, with the interest rates low, they are less attractive because you've got to put more money on deposit and, therefore, the return isn't great. So we would have put a structured bond together that Barclays Bank would have underwritten and then they would provide some derivative at the back end to provide the return, you know, the type of instruments that was coming close to maturity and that was at or above par and, therefore, the discussion with Barclays was relatively easy to break it because there was no cost to the investors and then we were able to transfer that then into Hauck & Aufhäuser. [51:23-52:09]*

Q. Should that money have been returned to the investors in that product? [52:10 – 52:11]

A. *We exited early and should have repaid it and we didn't. We put it into this Hauck & Aufhäuser on a back-to-back facility. [52:26-52:28]*

Q. Are clients aware that that is what has happened to their monies? [52:29-53:01]

A. No. [53:02]

Q. How many clients would be impacted? [53:03]

A. *I'm guessing maybe 25, but I might be out on that [53:04]*

Q. Who would have made that decision to place the money then with the private bank in Germany? [53:11-53:13]

A. *I would have made it and discussed it with John. But I would have made the decision. I mean, I would have led the discussions because John wouldn't be involved in Germany at all, so I would have discussed it with the bank. [53:14-53:18]*

Q. What are the terms now surrounding this particular money that is placed with the private bank? [53:19-53:20]

A. *Well, it's on a fixed deposit, achieving a fixed return-- say, the rate is I think 3.5% or there or thereabouts and the cost of finance is, say, 4.5, so we have got to pay the difference. That, as I said, is back-to-back. So the funds are held in the Alliamanic portfolio and then, when that property is sold, we will repay the bank and then they will repay us the deposit. [53:21-53:27]*

Q. I assume that if the ability to repay from Alliamanic doesn't realise, then obviously the private bank will obviously be able to take some of that money that's on deposit? [53.28-54:02]

A. *On the back-to-back, yes. [54:03]*

### Further on in the evidence of Mr. Harry Cassidy

Q. You said that there was one of these circumstances that you knew of. Are there others that would fall into a similar sort of category being used? [54:27-54:29]

A. *Well, unless you have something that I don't know about, that's my understanding of it.* [55:01-55:03]

### Mr. Harry Cassidy on 2 September 2011

Q. Perhaps then we can just move to an issue that arose in the course of our inspection of documents within the company and it relates to the payment of commissions to ARF on foot of a loan apparently given by CHC to CLIENT 44? [3:22-3:26]

A. *Commission paid to ARF?* [3:27]

Q. Hmm. [3:28]

A. *No, commission paid to ARF.* [3:29]

Q. Are you familiar with the loan? [4:01]

A. *Yes, I am familiar with the loan you are referring to, yes.* [4:02-4:03]

Q. Can you describe the circumstances around that loan. [4:04]

A. *Yeah, there is -- CLIENT 45 is a client of Custom House and a client of EPT, because it is a pension fund. And, CLIENT 45 we have done some other transactions with him, CLIENT 45 approached us because he was setting up a contracting business, he is in the building business, quite successful, but with the downturn in the Irish market work is difficult, and he was looking at the Middle East as a place for doing some business and he had made a lot of contacts. His difficulty in getting the contracts established in the -- or firmed up in the middle East is that under their local law they had to prove they had a certain value or net worth in the company at a period of time and he approached us to see if we could assist him.* [4:05-4:18]

Q. Hmm. [4:19]

A. *That entailed making a once-off lodgement to an account controlled by his company with, I can't remember the name of it, a bank in the middle East. so we considered that and we discussed it with him over several weeks and months, got assurances from him and his financial controller, COO<sup>24</sup> and obviously looked at the company and based on our relationship with him, agreed to make the lodgements. It would be returned in a couple of days, because it was only to be shown to go in and then be transferred out. Now, I think it happened over six or seven days because we had forgotten about the weekend being working days in the middle East, so it didn't come back for a couple of days. And so it left our account, into his account and it came back.* [4:20-5:05]

Q. Right. We have seen e-mail traffic which you were specifically involved in. I can actually produce these if necessary, whereby the e-mail effectively states that 25,000 commission had been agreed on the loan and that that should be paid and the payment instructions to ARF were supplied for -- the payment of that commission? [5:06-5:12]

A. *No, the payment wasn't paid to ARF, it was paid to me personally.* [5:13-5:14]

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<sup>24</sup> Text has been deleted and underlined text has been amended from the verbatim transcript by the interviewee

- Q. It was paid to you personally? [5:15]
- A. Yes. Not to ARF. [5:16]
- Q. That is the amount of 25,000, is it? [5:17-5:18]
- A. Hmm. [5:19]
- Q. Those funds appeared to come from the liquidation of the CHC Commodity Bonds? [5:20-5:22]
- A. The 25,000? [5:23]
- Q. No, the 2.5 million? [5:24]
- A. Sorry, I am confused. [5:25]
- Q. Yeah. [5:26]
- A. The 25,000 was paid to me by CLIENT 45's company. [5:27]
- Q. Yes. [5:28]
- A. Directly to me? [5:29]

**Further on in the evidence of Mr. Harry Cassidy**

- A. For any other transactions this was a once-off to assist CLIENT 45 and it wasn't. [7:23-7:24]
- Q: Right. [7:25]
- A. Sorry, it wasn't done to assist him in any leverage in anything -- it was done as a favour to ensure that he could show for a static date, whatever date it was, that he had x amount of money in the Bank account for the company and then they would fulfil that obligation that would allow them then to get a contract which they subsequently got. And what CLIENT 45 did for us, as in CHC, was and you will have seen the documentation simultaneously to that, because I asked him as part of the transaction was that he invested part of his pension fund in the debenture, which you would have seen the documentation on that and that was then subsequently repaid to him because he was one of the people who requested a repayment. [7:26-8:10]

**Further on in the evidence of Mr. Harry Cassidy**

- Q. Hmm. okay. Just before we leave the Barclays bond issue, there was, in the course of our investigation a document which turned up. If Noel could give you a copy of it (same handed). It appears to be a draft letter to send to holders of the bond under your signatures. It's dated, but it's not signed. Just to clarify for the record that is a draft letter dated 19th of August, 2009. You can keep a copy of it if you want. Is it a letter, a draft that you recognise? [9:17- 9:26]
- A. Yes. But I don't -- it never issued to clients [9:27].
- Q. Never issued. [9:28]
- A. And my understanding is that, I think we took legal advice in relation to what we were proposing and it just wasn't going to fly so we didn't send it. [9:29-10:02]

- Q. Right, okay. There is also another document that we came across in the course of our investigation. It relates to a Board resolution here and I am just wondering if you can confirm whether that Board meeting ever took place and whether the resolution was in fact a resolution of the Board? So this is a copy of a document titled 'Resolution of Custom House Capital Board of Directors meeting on 17th of November, 2009.' (Same handed) [10:03-10:11]
- A. *Yeah, that did take place because we were required to do so as part of the account opening procedure with Hauck & Aufhäuser.* [10:12-10:14]
- Q. Right. [10:15]
- A. *So they would have required and requested from us a resolution from the Board.* [10:16-10:17]
- Q. Right. And was a copy, a signed copy of that provided? [10:18]
- A. *I am sure it would have been provided to the Bank, because they would have looked for it.* [10:19-10:20]
- Q. So that meeting with the three directors did take place? [10:21-10:22]
- A. *Well, it would have to because we would have to sign off on it as directors.* [10:23-10:24]

**Further on in the evidence of Mr. Harry Cassidy**

- Q. Yeah. But in whose name was the deposit and in whose name was the loan? [11:29-12:01]
- A. *The deposit was put in the name of CHC and CHC's name appears on the account statements from Hauck & Aufhäuser which are available in CHC's offices. Paul or Finn had them- I have copies of the statements and the name would have been in the name of CHC.* [12:02-12:06]
- Q. Okay. [12:07]
- A. *And that, again, is reflected on the account statements.* [12:08]
- Q. Okay. And was the fact that this loan was given to CHC who then gave it to the SPV, I presume. Was that disclosed to the auditors? Would they have known that that loan was in the name of CHC? [12:09-12:12]
- A. *Well, again, from memory, I don't think I specifically told them that it was, but the reference to the loan as far as I recall, is shown in the companies' office, because there is a charge against CHC.* [12:13-12:16]
- Q. Hmm. [12:17]
- A. *In the name of Hauck & Aufhäuser and, therefore, the auditors, if they were doing their job, presumably got a copy of the companies' office or the registration.* [12:18-12:20]
- Q. Sure. [12:21]
- A. *And would have seen all the charges, because if you go into the companies' office, CHC, you will see 30 charges. Some of them were very specific and ring-fenced because they were non-recourse against M&F or against CHC and, therefore, didn't have a direct impact.* [12:22-12:27]

Q. Right. [12:28]

A. *But, again, from memory, when I looked at the Companies' office registration the last time, which was several months ago, the Hauck & Aufhäuser charge was still there.* [12:29-13:03]

**Mr John Whyte on 25 July 2011**

Q. Okay. That brings me into one of the other issues that I think you yourself raised in terms of bonds that may have been issued and cashed in.... [14:09-14:11]

A. *That would have been originally underwritten by Barclay's Capital. Now they would be going back historically to 2005/2006 etc... So in total they would have maybe been in the order of eight and a half to ten million Euros. What was used, those monies were transferred directly from Barclay's Capital, as far as I aware...* [14:18-14:24]

A. *...into a bank in Germany Hauck and Aufhäuser, a private bank.* [14:26-14:27]

A. *The only thing I was not too sure of was whether they were cash backs.* [14:29-15:01]

A. *Or whether they were sitting on deposit? But again if they are sitting on deposit my view would be that they would be cash backed against some property asset.* [15:03-15:05]

Q. Right. Are there any other such products as far as you are aware? [15:06-15:07]

A. *The only other products we have in the structured product range are the RBS Capital Protected Bonds, but they were completely ring fenced and held through RBS.* [15:08-15:10]

Q. They are not affected in any way as far as you are aware? [15:11-15:12]

A. *No, absolutely not. It is just the capital protected bonds that were underwritten by the Barclay's Capital that the banks, in my view, have a lien on.* [15:14-15:16]

**Mr Paul Lavery on 19 July 2011**

Q. I think I may have asked you already, Paul, if you were aware of -- maybe I didn't -- of assets of clients being used to... [42:05-42:07]

A. *Pay other assets?* [42:08]

Q. No, as collateral or security or being pledged against loans? [42:09-42:10]

A. *Not that I am aware of now, to be honest with you. I am trying to think back in my head. I think there may have been going back -- I seen something last week there when I was looking at one of the funds and I was trying to get back-up to it. There was an amount paid under one of the PRSA funds to Bank of Ireland as if it was -- I think there was a loan facility on the PRSA.<sup>25</sup>* [42:11-42:17]

Q. Would you have any knowledge of the capital protected bonds? [42:23-42:25]

A. *No, I wouldn't have any knowledge of them, to be honest with you. They are all arranged by Sean Kenzie who would have been in at the time. He is now gone, but he would have done all that directly with Harry.* [42:26-42:29]

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<sup>25</sup> Interviewee later stated that this was correct.

**Mr. Paul Lavery on 26 August 2011**

- Q. Paul, I want to really talk about what we have referred to as the structured products. These were products that related to Barclays -- Capital Protected Commodity Bond I think it was referred to as. Now, the last time we discussed it, I think you said that you didn't really have a great deal of knowledge about it, but I wonder if, now that you have had time to look over the issues, has anything else come to mind? [3:20-3:28]
- A. *Yes, under the Commodity Bond, we done some work on it whenever the guys were in from KPMG and we went through it and that. There was part of the bonds were actually realised and the money then was put on a deposit in a German bank called Hauck & Aufhäuser.* [3:29-4:04]
- Q. Yes? [4:04]
- A. *That money then was then borrowed against and that money is then invested in specific properties.* [4:06-4:07]
- Q. Yeah? [4:08]
- A. *I got all the statements from Daniel in Germany and I went through them all in the office and put a back-up behind each one of them and that was given to KPMG. There was, I think, about 6 million came from the bonds, six point something million or something like that, and the rest then was part came from Marienplatz-- I think about two point something million into that bank as well.* [4:09-4:16]
- Q. Just to clarify, was that from proceeds from a sale from the Marienplatz? [4:17-4:19]
- A. *Yes, yes, correct. So I think, in total, it was probably about between 7 and 8 million on that account.* [4:20-4:21]
- Q. When you say "that account", is that the deposit account? [4:22-4:24]
- A. *Yes.* [4:25]
- Q. We have seen documentation relating to a 5.3 or a 5.6 million deposit, I think? [4:26-4:27]
- A. *Mmm.* [4:28]
- Q. So is there an additional deposit on top of.. [4:29-5:01]
- A. *There is, yeah, correct, there is a deposit on top of that* [5:02-5:03]
- Q. Do the same conditions apply? [5:04]
- A. *It's in the same account.* [5:05]
- Q. Right? [5:06]
- A. *Yeah.* [5:07]
- Q. But it's held as a security against a loan? [5:08]
- A. *It's the exact same thing, yeah.* [5:09]
- Q. And that's proceeds of... [5:10]

- A. *Proceeds of the Marienplatz properties.* [5:11]
- Q. When did that take place? [5:12]
- A. *Jesus, that was -- I think it was 2009 type of thing, December 2009, if my mind serves me right.* [5:13-5:14]
- Q. Right, okay. [5:15]
- A. *So, basically, like, you know, I never really understood -- looking through the statements, effectively it looks as if -- imagine an amount of money put on deposit, right, the bank drew down on a portion of the money to match the deposit and that money then was then used to put into a specific property. A lot of money went into Allemanic retail property fund. So this looks as if any time there was a deposit, there was a matched drawdown on each occasion.* [5:16-5:25]
- Q. The deposit is in the name of? [5:26]
- A. *I'm not too sure, I think it's in the name of Custom House Capital.* [5:27-5:28]
- Q. And is the borrowing in the name of Custom House Capital as well? [5:29-6:01]
- A. *I'm not too sure. The account's name is Custom House Capital so I'd say it must be the same.* [6:02-6:03]
- Q. In relation to how that transaction was treated in the accounts held by CHC, how was that treated? [6:04-6:05]
- A. *It was never actually put through the face of the accounts in CHC.* [6:06-6:07]
- Q. Right. We have some e-mail traffic that suggests that you might have requested the setting up of a commodity bond fund on the Unity System to reflect the...[6:08-6:11]
- A. *Yeah, because what I done was I got them to set up the structure so you could track the money where it went to, effectively, because if the money came in from the proceeds of the commodity bond, I want to say 'Listen, this is where the money came into so you can see where it went to. Otherwise, you would have no information, no back-up, no nothing to trace the flows.* [6:12-6:18]
- Q. And how would you characterise then this account that appeared, the Commodity Bond Fund account? [6:19-6:20]
- A. *It is just set up as an ordinary entity on the Unity System.*[6:21-6:22]
- Q. But it doesn't exist as -- is it a suspense account type of...[6:23-6:24]
- A. *No, it was set up as just an entity and it just showed the money coming in and where it went back -- I am not too sure what the entry is, whether it was stockbroker or other.* [6:25-6:28]
- Q. Can you describe how the interest on the deposit and the loan are treated? [6:29-7:01]
- A. *Some of the interest has been covered by other funds. Like, through the Destiny funds, some interest has been paid from there.* [7:02-7:04]
- Q. Right? [7:05]
- A. *And, more recently, some interest has been covered from the interest earned on the deposit.* [7:06-7:07]

- Q. Again, my understanding was that the interest on the deposit was offset against the cost of the loan? [7:08]
- A. *I wouldn't know about that now, to be honest with you. All I ever seen was a charge coming to us and then Harry would say pay it from wherever. [7:10-7:12]*
- Q. When the Barclays Commodity Bonds were sold, the proceeds of that sale, can you describe what happened to the proceed of the sale before the deposit was placed? [7:13-7:16]
- A. *The proceeds were held on one of the Client Asset accounts and then that was transferred out then to that bank and then part of the money was transferred into further other costs in other properties from Dublin. They didn't go out to the German bank. [7:17-7:21]*
- Q. So some of it only went to the German bank? [7:22]
- A. Yes. [7:23]
- Q. Have you heard of a firm called CLIENT 44? [7:24]
- A. *CLIENT 44, yes, I have heard of them, yes. Your man, CLIENT 45, this individual, he had an account with us. What happened there was I always remember that there was a transfer done to him and Harry had agreed with him that he would do a transfer on the basis that he would invest money into the subordinated loan, the subordinated loan account. [7:25-8:02]*
- Q. Uh-huh? [8:03]
- A. *Then money was returned to the company within, I think, a week. [8:04-8:05]*
- Q. Right? [8:06]
- A. *All Harry told me at the time was that he had to do this transfer and he had to do it because -- I don't know for what reason he done it for your man -- and that the money was to be transferred out temporarily and it was going to come back in. [8:07-8:11]*
- Q. Yeah? [8:12]
- A. *I said 'We can't do that, you know, it's client asset monies' and, for some reason, I don't know why, he had agreed to do it with this guy. [8:13-8:15]*
- Q. How much was it? [8:16]
- A. *It was 2.5 million, I think. [8:17]*
- Q. So 2.5 million went out for less than a week and you don't know why? [8:18-8:19]
- A. *I think what he told me at the time was it was going across for some security for this guy who was doing projects in I think it was a Far East country -- I think it could have been the United Arab Emirates, UAE, and that the monies were over there. That's where it went. [8:20-8:25]*
- Q. Was there any payment made on foot of that? [8:26]
- A. *No payment made -- to us or to... [8:27]*
- Q. Was there a commission on that? [8:28]
- A. *No, there was no commission, no. [8:29]*



- Q. Because we have again e-mail traffic that suggests that €25,000 commissioning was charged on that transaction? [9:01-9:02]
- A. *Commissioning -- I'm trying to think now, to be honest with you. I need to check my records on that. Off the top of my head, I wouldn't remember that. But the amount 25,000 sounds sort of familiar to me.* [9:03-9:06]
- Q. Right, I don't know if we have an e-mail that we could... [9:07-9:08]
- A. *Maybe it was charged from M & F or something, was it?* [9:09]
- Q. Maybe I could just show you... [9:10]
- A. *Show me, yes.* [9:11]
- Q. I am going to show Paul an e-mail from Harry Cassidy, dated 10th December 2009, to CLIENT 46 and Paul Lavery. The subject was "transfer of funds". If I could just show you that there? (Same handed) [9:12-9:15]
- A. *Okay, I can check than back when I go back.* [9:16]
- Q. Do you recall that? [9:17]
- A. *Seeing it now, it does bring back the memory of that ARF Management.* [9:18-9:19]
- Q. So was 25,000 paid to ARF Management? [9:20]
- A. *I think it was, yes.* [9:21]
- Q. Can you recall when it was paid? [9:22]
- A. *It would have been the same sort of time -- I think it's probably 2009 I think that was.* [9:23-9:24]
- Q. Can you tell us why that was made? [9:25]
- A. *I have no idea how that figure was agreed or what agreement was in place between Harry and this guy. I wouldn't know, to be honest with you.* [9:26-9:28]
- Q. I suppose, there seems to be a confusion over whether the money would go directly to ARF or whether it would go through CHC accounts. Can you recall which way it went? [9:29-10:03]
- A. *I think it went to ARF Management.* [10:04]
- Q. Right, and would you have put that in to the ARF Management accounts? [10:05-10:06]
- A. *That would have been ARF Management accounts.* [10:07]
- Q. Would you have booked that in or... [10:08]
- A. *I would have had an invoice done up, yes.* [10:09]
- Q. Right? [10:10]
- A. *For Harry, at his request.* [10:11]

**Mr Sean O'Dwyer on 8 August 2011**

- Q. We have touched on the Equity and the Cash, but there was this other issue that arose during the course of the Inspection that was the issue in relation to these structured bonds and I think Barclays and RBS were involved? [16:02-16:06]
- Q. Have you any background knowledge on those before the Appian -- or, well, sorry... [16:08-16:09]
- A. *No, not the Barclays one. I suppose, I only became aware of the Barclays bond after you had your interview with Harry because I think he told you about it and then, like, I met him at six or seven that evening, Maurice and myself, and he said 'Look I better tell you this because I have told George and Noel', so he told us about it and, you know, to be honest with you, I was nearly ready to just leave the room and walk away from him, like; it's just terrible. So that was the first I knew of that Barclays bond at all. [16:10-19]*

**Mr. John Mulholland on 26 August 2011**

- Q. We came across in the course of our inspections a copy of what appears to be a Board minute. Maybe, I will give a copy of it to you and see whether you recognize it or can confirm that it, in fact, happened. So this is a copy of a 'Resolution of Custom House Capital Limited Board of Directors Meeting 17 November 2009'. So I am just passing you a copy of that and you can keep it. [5:14-5:22]
- A. *Okay. [5:23]*
- A. *I don't not recall seeing this before. [5:24]*
- Q. Right? [5:25]
- A. *And is there a copy that has been signed by... [5:26-5:27]*
- Q. No. Well, we haven't come across a signed copy, as yet. [5:28-5:29]
- A. *I don't not recall... [6:01]*
- Q. This is taken off the servers. [6:02]
- A. *Yeah. [6:03]*
- Q. Do you recall the meeting taking place, John? [6:04-6:05]
- A. *I don't recall the meeting taking place. [6:06]*
- Q. Would you know or be able to check whether or not a signed version of that document actually exists? [6:07-6:08]
- A. *I am not really sure who would have a copy of it or where it would be available from. Typically, what would have happened with a lot of the transactions that would have occurred is that there was a lot of paperwork was completed and the system evolved whereby it would be sent to me for signature and, usually, if it was sent to me with Harry's signature on it, I would cosign it. But I don't recall signing a document like this. [6:09-6:17]*

- Q. I suppose, recognizing that it is neither signed nor dated other than in the text itself, is there any chance that it was post -- that it was done up after the event? [6:18-6:22]
- A. *I honestly don't know. I hadn't any direct dealings with Hauck & Aufhäuser and, frankly, I don't even know which city it's in. But I don't know whether this would have been done afterwards. I can't see any reason why. But you are saying there is no signed copy of it; this it is just taken from...* [6:23-6:28]
- Q. You know, we took a dump of the various PCs and this is one of the items that was held on those PCs? [6:29-7:01]
- A. *Uh-huh.* [7:02]
- Q. Okay, well, if you have no recollection of it, do you have any -- would this be a normal way of proceeding in the company? Is this the manner in which these resolutions was done up? [7:03-7:06]
- A. *I think, normally, what would have -- or what should have happened, perhaps, is that they might be done in this fashion and, maybe, they mightn't always have been done with all the directorships, I'm not too sure.* [7:07-7:10]

#### **Other witnesses**

No other witness professed having any material knowledge of this issue to the Inspectors.

### **6.3 Forensic Examination by KPMG**

Following the receipt of the amount of €7,366,016.03 referred to above, an internal email dated 24 November 2009 [KPMG Exhibit 89] confirms that these funds were lodged on Paul Lavery's instruction to the Client Asset Gross savings account ("CAG"). An internal email dated 26 November 2009 from Paul Lavery contains an instruction to establish a record called 'CHC Commodity Fund' on the CHC internal system to reflect the cash received from Barclays Capital. [KPMG Exhibit 90] Over the course of the next month this money was disbursed by CHC to meet a range of demands.

KPMG's review of the CHC Unity system records indicates that €296,579.88 was used to meet two client redemption requests. An email from Michelle Donnelly to Paul Lavery dated 8 December 2009 [KPMG Exhibit 93] covers one of these payments describing a transfer of €123,286.12 from CAG/CHC Commodity Bond Fund which will be reflected on the Unity system as 2 amounts - one transferred from Destiny 19 (€122,360.95) and one from Destiny Client Savings (€925.17).

A further €1,564,644.35 was transferred in 8 separate transactions to various European property funds. Some of these were used to meet client redemption requests from those property funds.

On 15 December 2009 an amount of €5,600,000, recorded as a bank deposit, was transferred from the CAG/CHC Commodity Bond Fund to the German private bank, Hauck and Aufhäuser [KPMG Exhibit 92]. An email dated 30 November 2009 [KPMG Exhibit 95] was sent from CH Asset Management Germany GmbH to Mr Harry Cassidy, and copied to Mr Paul Lavery, setting out the form of a resolution required by the German bank to be passed by the directors of CHC '*...regarding the decision to open an account with them and take out a loan (with pledge of fixed term deposit) with them ...*'. Initially, in the course of the investigation, there was some uncertainty as to whether the required form of resolution had been duly passed. On 14 October 2011 a copy of the resolution of the Board, signed by Mr Cassidy, Mr Whyte and Mr Mulholland and dated 30 November 2009, was furnished to the Inspectors by CHC, which had obtained the form from Hauck & Aufhäuser. [Inspectors Exhibit 4]. Mr Cassidy also stated that the loan provided directly to CHC is secured by a pledge in favour of Hauck & Aufhäuser over a fixed term deposit held in the name of CHC. The Companies Registration Office file for CHC records that on 10 December 2009 a pledge over a fixed asset deposit plus account balances and securities deposits and claims was created by CHC in favour of Hauck & Aufhäuser Privatbankiers KGAA. [Inspectors Exhibit 5]

However, KPMG's review of these transactions also disclosed a series of transactions which occurred immediately before the transfer of money to Hauck & Aufhäuser. An amount of €2,500,000 was temporarily lent by CHC to a property development company operating in Abu Dhabi. The funds were transferred from the CAG/CHC Commodity Bond Fund on 11 December 2009 to the National Bank of Abu Dhabi and returned on 14 December 2009 [KPMG Exhibit 93]. A fee of €25,000 was paid by the property development company for the temporary use of these funds. An email dated 10 December 2009 sent by Harry Cassidy to the property company and Paul Lavery stated '*...was I not to invoice you on the fee of 25k...how is this being reflected in your accounts? The invoice has to be made out to a separate company ARF Mgt Ltd*'. Mr Cassidy stated on 2 September 2011 that this amount of €25,000 was paid directly to him.

A draft of an explanatory letter to the clients who were the beneficial owners of the Commodity Bonds was prepared by CHC in August 2009. In the event this letter was not issued to clients. It would have set out a proposal for realisation of the bonds, with the proceeds to be used for investment in property opportunities in Europe and the United Kingdom, and investors to be offered an enhanced return. This was in the following terms<sup>26</sup>:

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<sup>26</sup> Mr Whyte disputed that discussions had taken place with him on this matter. Having regard to the considerations outlined at paragraph 1.13 above, the inspectors have been unable to form any conclusion on this.

**Strictly Private & Confidential**

19<sup>th</sup> August 2009

Dear Investors

Following discussions with John Whyte, Investment Director, I am setting out the proposal that CHC would like to put to you in relation to your current guaranteed structured bond. As you are aware, these bonds are due to mature over the next 3 to 4 years and the bond is 100% guaranteed with the uplift based on the performance of the underlying assets in the bond, namely hard and soft commodities as we outlined at the launch.

In the current market, it is extremely difficult to raise finance from commercial banks for property and other investment purposes. There are however, a number of exciting opportunities available if equity/loans were available as property values have fallen, yields have moved out and cost of funds from the banks has fallen dramatically. All these factors lead us to believe that we could take advantage of that situation if cash was available to us.

What we are proposing is that we would use the cash guaranteed deposit that is currently held by Barclays Capital (supporting your bond) as security to raise approximately €6m from a commercial bank over the next 3-4 weeks. This facility would be for a period of 2 years and the cost of the borrowings (interest) would be entirely covered by Custom House Capital Limited. Indeed, Custom House Capital Limited would also ensure that no risk would attach to your bond and that the full loan would be repaid to the bank before your bond matures. To facilitate that, we would set aside capital on a regular basis in a separate deposit account which would ultimately grow to equal the amount borrowed from the bank and therefore the loan would be repaid in stages.

Our objective is to use the monies raised (€6m) to take advantage of some property opportunities that exist in the marketplace, both in Europe and in the UK. We would reward you for providing this facility and agreeing to the loan by adding an additional 6% per annum to your initial investment over a 2 year period. This would have the ability of increasing a typical investment of €150,000 by €9,000p.a. (adjusted for the period of the loan if less than a full calendar year.

We have broad agreement from a bank to provide this facility, provided we obtain the clients' approval, which we are now seeking.

It is likely that we would borrow 60% of the total value of the bond (€10m) and that that €6m raised would be invested in a number of projects to include German retail centres, a small UK commercial unit (mixed use of office and retail) and an office development (new) in France.

*Y:\CHC M Drive\CHC Data\Commodity Bond\Client corr 190809.doc*

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I believe this is an innovative way for us to raise additional capital to take advantage of market circumstances and at the same time rewarding investors by an additional enhanced return to the structured bond, which remains guaranteed.

If you have any queries on this, I am more than happy to discuss it with you and we will be contacting you over the next week to ten days. Key points to note are as follows:

- If approval is obtained, the bank would take security over the existing bond held by Barclays Capital
- Custom House Capital Limited will service the interest on that facility (maximum €6m)
- Custom House Capital Limited will provide a deposit facility to repay the loan over a period of 2 years
- Custom House Capital Limited will undertake to ensure that the loan is repaid in full prior to maturity of the loan facility
- Custom House Capital Limited would enhance the return on the investors' structured bond by 6% gross per annum.

Kind regards,

Harry Cassidy  
**Chief Executive Officer**  
**Custom House Capital Limited**

#### 6.4 Conclusions

It is clear that investments held on behalf of certain clients of CHC were sold without their prior or subsequent knowledge or consent. CHC has not disclosed this sale to clients, and has issued a portfolio valuation to a client as at 30 September 2010 purporting to show the commodity bond as still held for that client [KPMG Exhibit 96]. The proceeds of that sale, €7,366,016.03, were used to meet various cash demands ranging from meeting unrelated redemption requests of other clients to the placement of a deposit with a German private bank as security against a loan to CHC which was used to finance the CHC Allemanic Fund. It should also be noted that the interest paid by CHC on its loan from Hauck & Aufhäuser was the difference between the rate purportedly being earned on the fixed term deposit and the rate charged on the loan. The fixed term deposit and the loan are both held in the name of CHC.

Separately €2.5 million of funds then held for those clients was temporarily loaned to a property company operating in Abu Dhabi. A fee of €25,000 was charged for this facility.

## 7. MEZZANINE BOND FUND

### 7.1 Introduction

In February 2009, information was received by the Central Bank from an individual to the effect that some CHC clients' monies were being invested in an investment framework described as the Mezzanine Bond Fund and that this was being done without the clients' knowledge or consent. While CHC may have had investment discretion to make such loans on behalf of clients in some instances, the information received by the Central Bank was that not all of the clients involved were such discretionary mandate clients.

The information received by the Central Bank was that the Mezzanine Bond Fund was being used by CHC to provide loans to geared (or leveraged) European property structures entered into by CHC on behalf of certain clients. This was done with a view to the clients whose funds were being used to provide the loans being repaid with interest over a five year period as new investors were obtained for those structures or from surplus income derived from the underlying properties or as such properties were sold. Specifically the fund had been created to enable CHC to assist in the short term financing of properties in the European market.

A promotional and information document in respect of CHC Mezzanine Bond Fund can be found at [Inspectors Exhibit 6] and page one of that document describes the key features of the Bond. Certain information about the Mezzanine Bond was given to investors by CHC in a letter from Mr Harry Cassidy dated 17 December 2008. This contained a statement that CHC had decided to place relevant funds of clients in the Mezzanine Bond, although the investment of funds had actually already been made the previous month. [Inspectors exhibit 7]

Notes 1.9 and 20 to the audited financial statements of CHC for the year ended 31 March 2010 [Inspectors Exhibit 8] provide some background information as follows:

#### ***"1.9 Going concern***

*Normally the company meets its day to day working capital requirements by way of the client fees from both private client and property related activities. During the past 12 months the company negotiated an overdraft facility of €250,000 with their bankers (payable on demand) and this facility is utilised to augment the fees to cover working capital needs.*

*The nature of the Company's business is such that there can be considerable unpredictable variation in the timing of cash inflows. The Directors have prepared projected cash flow information for the period ending 12 months from the date of approval of these financial statements. On the basis of this cash flow information, the Directors consider that the Company will continue to operate within the facility currently agreed. The Company's cash inflows are significantly reliant on the recoverability of debtor balances from property related entities. The Directors do not consider any further provisions are required in the financial*



statements in this regard, other than those recognised and reflected in the balance sheet of the Company.

The Company has a contingent liability to a guarantee provided by it under the Custom House Capital Limited Mezzanine Bond Fund (the "Bond") (note 20). The Directors believe it is not probable that a transfer of economic benefit will be required to settle their obligation under this guarantee.

The Directors consider it appropriate to prepare the financial statements on the going concern basis. The financial statements do not include any adjustments that would result from a withdrawal of the overdraft facility by the Company's bankers, the non-recoverability of significant debtor balances or the crystallisation of a liability under the guarantee provided by it under the Bond."

## **"20 Contingent Liabilities**

### **Mezzanine Bond**

The Company created and promoted the Custom House Capital Mezzanine Bond Fund ("the Bond"). A term of the Bond states that the Company guarantees up to 100% of the investors' funds, plus a fixed return of 5% - 7% per annum (net of management fees of 0.5% per annum).

At the year end, it has been estimated by the Directors, that the exercise of the guarantee by the investors could give rise to a maximum liability to the Company of €15,800,709 (2009: €16,558,349). This liability could arise in a situation where the Property Investment Funds ("the Funds"), in which the proceeds of the Bond were advanced, defaulted in the repayment of those advances. The Funds to which the proceeds of the Bond were advanced are supported by properties valued at €115,625,000 as at 31 December 2009. The Directors estimate €11,932,876 of this value is available to Bond holders, after taking account of senior bank debt. Consequently, in the event of default the Directors estimate that this could result in a contingent liability of €3,867,833 for the Company, under the guarantee. The directors believe it is not probable that a transfer of economic benefit will be required when the bonds mature at a future point in time.

The Funds could default, at maturity of the Bond, if the value of the Properties, in which funds were invested, fall below the combined liabilities owed through senior bank debt to Financial Institutions and the Bond proceeds invested.

The Bond has varying maturity lengths, the earliest of which is not due to mature until 19 December 2012. The Funds' accounts are prepared on a going concern basis. The Directors consider the possibility of these Funds being in default, at maturity of the Bond, to be remote.

At the balance sheet date, the Directors are of the opinion that no event has arisen that has crystallised a liability against the Company in relation to the Bond and no provision has been made in the financial statements."

The auditors' report on those financial statements of CHC contained the following paragraph:

### **"Emphasis of matter - going concern**

In forming our opinion which is not qualified, we have considered the adequacy of the disclosures made in note 1 of the financial statements concerning the Company's ability to continue as a going concern. The Directors have prepared projected cash flows for the period ending 12 months from the date of signing these financial statements. There can be considerable unpredictable variation in the timing of the Company's cash inflow. The

*Company's cash flow is also significantly reliant on the recoverability of debtor balances from property related entities. These conditions, along with other matters explained in note 1 to the financial statements, indicate the existence of a material uncertainty which may cast significant doubt about the Company's ability to continue as a going concern. The financial statements do not include the adjustments that would result if the Company was unable to continue as a going concern."*

On receipt of this information in February 2009 the Central Bank initiated authorised officer inspections of CHC early in March 2009, on foot of which a number of requirements were imposed by letter dated 17 June 2009 [Inspectors Exhibit 9] and in addition certain directions ((ii) below) were imposed on CHC under the MiFID Regulations on 26 March 2009, including:

- i) CHC was required to clarify the financial position of each syndicated SPV (special purpose vehicle used for holding an individual property) with particular reference to identifying current valuations compared with valuations at the time of purchase along with any shortfalls in equity being raised;
- ii) 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; and
- iii) An increase in the regulatory capital requirement (for capital adequacy purposes) to €5,000,000 in order to cover potential liabilities arising for CHC on the Mezzanine Bond.

Copies of these and all the directions referred to in this affidavit are to be found at Inspectors Exhibit 8.

The Central Bank also requested at a meeting with CHC on 7 April 2010 that CHC obtain an independent third party guarantee in relation to the Mezzanine Bond, however CHC could only obtain a proposal for insurance relating to the operation of the Mezzanine Bond. The purpose of the insurance policy was to afford a better level of protection to investors in the event that not all monies can be returned. The insurance policy was put in place on 28 May 2010. Clients of CHC were advised in June that this insurance policy was now in place and a draft copy of the notification to clients is at Inspectors Exhibit 11.

In the course of the above exchanges with CHC in 2010 further directions were imposed on CHC, requiring it (among other things) to segregate any returns to the Mezzanine Bond in a separate client account and not to make any payment out of this account (direction dated 7 April 2010 and amended on 18 February 2011).

On 9 February 2011, the Central Bank issued letters to CHC and Mr Harry Cassidy outlining alleged contraventions of regulatory requirements relating to the sale of the Mezzanine Bond to clients and an administrative sanctions procedure under Part III C of the Central Bank Act 1942 (as amended) was initiated. Responses were submitted on 6 April 2011 supported with 2 folders of documentation. These responses are being considered by the Central Bank in the context of that procedure, on foot of which significant sanctions including monetary penalties and/or directions disqualifying persons from being concerned in the management of a regulated service provider may be imposed. A copy of the letters of 9 February 2011 to CHC and to Harry Cassidy can be found at Inspectors Exhibit 12. The fact that an administrative sanctions procedure has been initiated is entirely independent from this investigation.

The current position on the Mezzanine Bond is that €10.4 million (exclusive of interest) is owing to investors. The original regulatory capital condition imposed on CHC for capital adequacy purposes which required it to have €5 million capital has been varied to take account of the fact that CHC now has to deduct any contingent liability arising on the Mezzanine Bond when calculating the regulatory capital of CHC. This took into account the fact that the estimated contingent liability for CHC would vary reflecting the most recent valuations on the relevant properties/SPVs in respect of which Mezzanine Bond funds had been loaned. This appears from a letter issued by the Central Bank to CHC on 17 November 2010, a copy of which may be found at Inspectors Exhibit 10. Issues arose in April 2011 in relation to the method of calculating the contingent liability amount and the Central Bank has sought to determine where the Mezzanine investors ranked in respect of entitlement to proceeds of sales of the underlying properties partly financed by the Mezzanine Bond.

CHC previously advised in a letter to the Central Bank dated 16 August 2010 [Inspectors Exhibit 13] that "Mezzanine finance ranks equally with equity holders". However at a meeting between the Central Bank and CHC on 5 April 2011 the Central Bank was informed by Mr Cassidy that the Mezzanine finance ranked ahead of Equity investors and CHC later, by email dated 20 April 2011, maintained this position (that Mezzanine investors rank ahead of the Equity investors). A subsequent communication on 3 June 2011 from CHC to the Central Bank stated that in a liquidation scenario or a return of capital to investors from property SPVs, if there is a shortfall in capital, the Mezzanine Bond would rank *pari passu* with the investments made by other investors in the SPV. CHC also confirmed in that letter of 3 June 2011 that the documentation available to CHC regarding the Mezzanine Bond's investments in the SPVs is deficient, and that CHC had sought independent legal advice on this matter.

As at 31 March 2011 the contingent liability appeared to amount to €5,121,834 and this, together with the uncertainty created by the contradictory communications which had been received from CHC regarding this issue, raised serious concerns regarding CHC's "own funds" / capital adequacy position. Further details of the Central Bank's inquiries and CHC's responses on this subject are set out in section 7.3 below.

## 7.2 Sworn Testimony to Inspectors

The inspectors asked the witnesses to clarify, where possible, the ranking of Mezzanine debt against equity holders. The following statements, including questions where relevant, are taken from those sworn witness statements:

### Mr Finn O'Connell on 15 July 2011

Q. In relation to some of the specific issues like the pari passu issue, were you involved in that issue? [43:17]

A. *I mean that was one particular issue where, you know, and this came up -- this has been an ongoing issue for a long time. I was part of the discussion, and certainly my comments to Harry at the time, in a meeting with Deirdre Canavan, was that the documentation that I had to hand didn't confirm that it was pari passu, and Deirdre said that, well, we'll get confirmation from the local solicitors, [and the next thing, I was on an e-mail to say, you know, please confirm these are pari passu, and this is the wording you need to use, and I raised that separately. Again, and I have file notes to that effect, to where it said, you know, this is not what we said we would do.] What we said we would do is get confirmation that it was pari passu. We would not just simply tell the solicitors can you give us a letter to say it is pari passu. [43:19-44:06]<sup>27</sup>*

Q. Right. [44:07]

A. *And I would share the view that you expressed. I certainly think in terms of -- you know, I have till yet to see a piece of paper that says to me this is why the Luxembourg solicitor said that document is pari passu. [44:08-44:12]*

Q. Right. [44:13]

A. *But I was again CC'd on e-mails where it was stated,<sup>28</sup> you know, Finn has agreed this or Finn has confirmed this, and nothing could be further from the truth. And I have personal handwritten notes where I had a conversation with Deirdre, and told her, This is not what I said. [44:14-44:18]<sup>29</sup>*

### Ms Leslie Coulter on 26 July 2011

Q. And your letter to or your contact with Arthur Cox, you said you put them on notice? [24:08-24:09]

....

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<sup>27</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

<sup>28</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>29</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

A. *They actually phoned me and said, it was after, it was actually the day of that last meeting in here, we were meeting them that evening. [24:12-24:14]*

...

A. *It was actually with, we had the partner, we had a meeting with the partner, Conor McDonnell and Elizabeth Upton, Elizabeth actually phoned me the next day and said "Are you okay? You seemed very uncomfortable in the meeting", and I said to her "I am just not", at that stage I had nothing. [24:16-24:21]*

...

A. *And I said "I just am not, not comfortable", I said, "and I cannot put my finger on why". [24:25-24:26]*

Q. Yes. [24:27]

A. *"But I just don't think what they are saying is right, and I don't have any evidence for it but I am about to start a trawl and I will get back to you". [24:28-25:01]*

Q. Yes. [25:02]

A. *She said "Well it was quite evident that you weren't comfortable. I will tell you where we are; we don't exactly believe them anyway, either because with the documentation that we have there is just no way that they can get the, the conclusion of *pari passu* and everything else that goes with it". I said "well that is where I am coming from as well and I don't" – we had a long conversation, I had a long conversation with Elizabeth prior to those meetings and she was very much, you know, you have to tell us the truth, no matter what it is you have to tell us because if we advise you we are advising in a vacuum and the advice is not correct. Obviously being a lawyer myself I know that so I just was like there is, I just didn't know what it was and then I found, I found it. So I gave them the documents and said "listen I found this and I don't, I don't believe the intention ever was *pari passu*". [25:03-25:20]*

#### **Further on in the evidence of Ms. Leslie Coulter**

A. *Yes, it was a series of e-mails from around about May/June last year where CHC asked the lawyer, Thomas Held, to change the subordinated loan note that states that it is ranked subordinated to, to change that to *pari passu*. [26:12]*

Q. Right? [26:17]

A. *And there is a whole string of e-mails that says well this, you know you have signed off on the draft and you knew it was subordinated to and now you are changing it to *pari passu*. So to me when ever Cox, Cox had asked for the backup to that and then you had subsequently asked for the same thing and I was like we don't have the backup, we instructed the lawyer to do it, so I mean there is no backup. We told him that he had it and he did, silly or not silly he did. [26:18-26:26]*

Q. Yes. [26:27]

A. *And then I was, and then he has -- then when we went back again this year I had sort of said if you push him too much well he is going to say that you, CHC asked him to, and he has in an e-mail of recent times in June 2011 said "as per your instruction". [26:28-27:03]*

Q. Right. [27:04]

A. *So there is no backup. We have a letter saying that it is pari passu, from Thomas Held in AMMC<sup>30</sup> Law, but it is on the instruction of CHC, and I have those e-mails. [27:05-27:07]*

...

Q. *And those e-mails were from who? [27:09-27:10]*

...

A. *Deirdre Canavan to Thomas Held. And again they go from about June to September and then they stop. But I would, reading between the lines I would say they stop because we got the letter from Thomas Held, but again just sort of never talked about again type of thing. [27:13-27:17]*

Q. *Where -- did you make copies of those? [27:18]*

A. *I have them, yeah. [27:19]*

Q. *You have them separate to - [27:20]*

A. *Yes and I will furnish them, I have given them to Sean and Maurice as well because I escalated it to them. Because then I was sort of like, I immediately said to Sean, and then I said as an approved person I am under an obligation here with the Central Bank that what we have put in on the 3rd of June is not right, and now I know it is not right, and we took the decision that we would do an internal investigation, and depending on what came out of that then I would make the disclosure to you guys. [27:21-28:01]*

...

A. *But then it sort of took a backseat because of what now has happened, so it didn't really go anywhere. [28:03]*

#### **Mr Maurice Harte on 11 August 2011**

A. *Now, that was really to respond to a letter from the Central Bank in a clear and complete way after taking some advice in relation to where things were. As a result of that, that work, it was clear that the information in the documentation on the Mezz Bond was, at best, insufficient or inadequate and, also, Coxes quite rightly would have said that they don't have any expertise on the overseas legal side, but they were very helpful in clarifying what the approach should be and, indeed, advised the Committee and CHC at that stage in relation to that. That particular meeting took place with Coxes where the stated intention of the company was, as in the correspondence, I think around the 3rd of June, which was that the Mezz Bond would rank basically pari passu with certain conditions, but that was the intention of the company. That particular letter was approved by the Board of CHC. Now, I wasn't on the Board, but rather than that I wanted to make sure that in terms of any response, that a response was a fully considered response by the Board of CHC, by the Committee and by the legal advisors as well. [26:03-26:23]*

Q. *You are aware that there apparently were substantial inconsistencies? [26:24-26:25]*

A. *Yeah. [26:26]*

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<sup>30</sup> Underlined text has been added to the verbatim transcript by the interviewee

Q. And they could be characterised, I think, as contradictions in the material that had been sent to the Central Bank over a period in advance of your own arrival, but was there any explanation given why that might have been the case? [26:27-27:02]

...

A. *As I said earlier, the first meeting was around the 22nd of March. Then I got a copy of or was informed of a communication by one of the directors in April, I think, which was suggesting a different approach in relation to the treatment of Mezz Bond, which you went through yourselves.* [27:05-27:10]

...

A. *Then I would have asked for copies and a review of all correspondence that affected the Property Committee and I was given a selected file on that.* [27:12-27:14]

...

A. *Which is fine. It didn't deal with other issues which I would be conscious of now, but it did affect things like the Mezz Bond and the calculation, so, yes. And from reading the correspondence and going backwards and forwards, which was going on for some considerable time, what appeared to be happening is that issues were continuing to grow, rather than being dealt with, and I said at the Property Committee that, particularly on the Mezz Bond one which I was very concerned about, that the way of dealing with this would be to get legal advice, independent legal advice for the Committee and for the Board, certainly for the Committee, and also on the calculation of the contingent liability, based on that structure, to get that independently verified as well and that was the purpose of the meeting with Arthur Cox and, indeed, the meeting with MKO to deal with that and to deal with the flow of funds. It became very, very clear to me at that point that the only way trying to respond fully to what occurred there was to do a cradle to grave review of funds flow from clients all the way through and how that was handled and how that was documented and how that was actually approved and who signed what mandates. Indeed, part of that exercise and I also asked on the Property Committee, which should be in the minutes, for a review of all the memoranda that would have gone out to clients to ensure that they were consistent with what I understood to be the case, and I was talking about even LTV covenants or loan to value because a lot of memorandums like that would suggest we will not go beyond a certain LTV etc. etc. But then that became even more important vis-à-vis the understanding of what occurred in the Mezz Bond.* [27:16-28:19]

#### **Ms Suzanna Cummins on 8 August 2011**

A. *There was no documentation for the transfers and that did concern me at the time. How I had looked at validating the figures was that we went to the accountants and said we need to disclose the amount in the accounts for the amounts that are owed back to the Mezzanine Bond and that got done with the exception, I think, up to the time I left, I don't think it was done for -- it might have been Le Patio or -- all the names of the properties escape me. It was Le Patio or the other one...* [10:06-10:15]

Q. The other French one, is it? [10:16-10:17]

A. *The other French one, yes.* [10:18]

Q. Plein Ouest? [10:19]

A. *Plein Ouest, yes. That was the other big amount. So, up to the time I left, I think those two were still outstanding. But all the rest of them had the amounts disclosed in the next set of*

*accounts, which that gave me comfort because, I mean, if the accountants were willing to sign off on the accounts, you'd have to put some reasonability over the figures that they were -- that it was okay. Having said that, I have to say that, since leaving, that one piece, that one spreadsheet with those transfers has always -- I don't know if the word is "haunted" but because there was never any back-up documentation in relation to it. [10:20-11:02]*

Q. Did you talk to Harry about them directly or... [11:03-11:05]

A. *Oh, I did, with Harry and Paul because, as an accountant, to Paul, I said 'Paul, I can't understand how you would do transactions without back-up documentation. I mean, you can't just...' -- and even when we looked at the previous versions of that reconciliation that was done, I couldn't understand where he was getting one figure to the other, but, you know, they said 'Oh, look, I know it wasn't right, we shouldn't have been doing it that way, we should have had back-up documentation, we'll make sure we do that in the future'. I know there was no controls around it. So I said 'Look, that needs to improve' because there was considerable circumstances like that where there was a lack of back-up documentation for some transactions, particularly on the properties. [11:06-11:20]*

### 7.3 Previous Correspondence

Severe difficulties had been encountered by the Central Bank with CHC in clarifying the Mezzanine investors' ranking in SPVs compared with the properties' equity investors. A review of meeting notes made by the Central Bank and correspondence between the Central Bank and CHC sets out the lack of consistency in the answers being provided to the Central Bank's queries on this matter.

- Meeting with CHC 5 April 2011: [Inspectors Exhibit 14].

The Central Bank's notes state:

"Mr Thompson stated that he had conversations with Harry Cassidy after the spreadsheet containing the calculation was submitted to the Central Bank and also had a conversation with John Whyte about the ranking between Mezzanine Bond holders and Equity holders. As there appeared to be some discrepancies over the information provided the meeting was arranged in order to get some clarification on the matter. Mr Thompson asked Mr Mulholland in his role as Director of CHCL and as Director of a number of the SPVs what was his understanding of how investors in the Mezzanine Bond are treated. Mr Mulholland stated that he was not in a position to answer this issue and deferred to Mr Cassidy.....

Further on the minutes state:

".....Mr Cassidy had stated in a conversation with Mr Thompson last week that the Mezzanine holders rank above the equity clients. Mr Whyte stated that the firm had written to clients previously stating that the mezzanine ranks pari passu with equity. Mr Thompson asked Mr Mulholland as a director of the firm and also a director of



some of the SPVs what his understanding was. Mr Mulholland stated that it was his understanding that it ranked pari passu with the equity investors Mr Cassidy stated that the Mezzanine investors had no charge against the SPV. If a property is sold senior debt i.e. bank debt is paid first then the next debt is the Mezzanine and then investors through loan notes and then equity. Mr Cassidy stated that the Mezzanine holders do not get any benefit on the upside of any property. Mr Clarke queried whether the holders of loan notes get any interest. Mr Cassidy confirmed that no interest is paid on the loan notes. The split between the shareholder loan notes and equity holders is 85%-15% respectively. Mr Cassidy explained that in the event of early repayment to investors, pay loan notes first so they won't be liable for income tax and then pay equity holders. Mr Cassidy explained that this type of structure is not specific to CHC and he confirmed that all the SPVs have the same structure. Mr Thompson stated that the equity was not broken down into loan notes on the spreadsheet submitted. Mr Cassidy stated that all the structures are done the same way and that Deloitte had given tax advice in respect of early repayments. Mr Cassidy stated that the loans notes are subordinated against senior debt and any other debt including Mezzanine."

Following on from this meeting, and in an attempt to clarify the issues at hand, the Central Bank wrote to CHC [Inspectors Exhibit 15] requesting:

*Please provide the following information in respect of each of the following entities / investments:*

*a) Futura II Holding SA*

*b) Hamburg Altona SA*

*c) Dominium Dortmund SA*

*d) PleinOuest*

- 1. A copy of the terms of business applicable to investments by clients in each of the entities /investments. Please provide a copy of the terms of business in force at the time of the investments and any updated version of the terms of business since that time.*
- 2. A copy of any investment memorandum, prospectus or equivalent document provided to clients.*
- 3. A copy of the information set out below in respect of each of the entities mentioned above:*
  - a) The full legal name of each entity*
  - b) The place of incorporation of each entity and its registered office*

c) *The directors and shareholders of each entity from inception to date, including the dates of office of each director, and the date each shareholding was acquired or disposed of*

d) *The constitution, certificate of incorporation or other equivalent constitutive document*

e) *The Memorandum and Articles, or the equivalent documents*

## *Appendix 2*

*Please provide the following information in respect of each of the following entities / investments:*

e) *Futura II Holding SA*

*Hamburg Altona SA*

*Dominium Dortmund SA*

h) *Plein Ouest*

1. *A copy of any advertisement, circular, presentation or equivalent document provided to clients or made available to clients at the time of investment or since.*
2. *A copy of any facility letters, letters of sanction and any other documents evidencing the terms on which the investments have been financed by banks or financial institutions.*
3. *A copy of any agreements entered into between the firm or any related or associated entity of the Firm and the following entities:*

- Futura II Holding SA*
- Hamburg Altona SA*
- Dominium Dortmund SA*
- Plein Quest"*

CHC's responses in April 2011 to the above request for information resulted in the submission of information that appeared to indicate that the equity and subordinated loan note holders rank below all debt including Mezzanine. This information conflicts with a letter sent to the Central Bank in September 2010 which stated:

*'CHC Mezzanine Bond Fund investment... ranks pari passu with investor funds owing under the shareholders account of the Company (ranks pari passu with the subordinated interest free loan notes*

*held by the shareholders of the Company...) on a going concern basis and in a liquidation situation' and 'all current shares... are in one share class all holding the same rights including a) on a going concern basis and b) in a liquidation situation'.*

The Central Bank subsequently wrote to CHC on 16 May 2011 [Inspectors Exhibit 16], highlighting that the information submitted in 2010 clearly conflicted with the information submitted in April 2011. CHC was requested to submit the legal documentation to support the firm's letter of September 2010. CHC was also requested to provide all relevant legal documentation supporting the introduction of Mezzanine Bond monies into the SPVs from CHC listed above and a full explanation of the contradictions contained between the recent information submitted and the information submitted in September 2010 by CHC.

CHC's response on 3 June 2011 [Inspectors Exhibit 16] stated that *"the documentation available to the firm regarding the Mezzanine Bond's investment in the SPV is deficient"*. CHC also stated *"given the deficiencies in the documentation referred to, we are not in a position to respond adequately at this point in time to those queries"*.

A meeting with CHC was subsequently arranged to address these issues on 22 June 2011. During that meeting [Inspectors Exhibit 17] the Central Bank stated:

*"In respect of the contingent liability on the Mezzanine Bond there were three different submissions from CHC varying from the Mezzanine Bond ranking pari passu to then ranking ahead of equity investors and now to it was always the intention to rank it pari passu. The Central Bank stated that this was completely unacceptable. CHC were informed that if it were not for the ongoing proposed corporate restructuring in respect of the Appian and Signature deals, the Central Bank would have no option but to pursue a revocation of CHC's authorisation."*

The Central Bank subsequent to this meeting, issued a letter to CHC [Inspectors Exhibit 18] noting the outstanding documentation and requesting by close of business on 29 June 2011 a detailed action plan to address how these issues will be rectified. This letter set out:

*"As discussed during the course of our meeting, a significant number of items remain to be resolved in relation to the Mezzanine Bond's investment in certain SPVs. The firm is requested to provide the Central Bank with a detailed action plan to resolve all items that need to be addressed, including but not limited to outlining specific timelines on when the following matters will be finalised:*

- *Legal advice from Ronne & Lundgren / AMMC Law in relation to the classification of the Mezzanine Bond within the relevant SPVs.*
- *MKO Partners review and validation of the calculation of the contingent liability figures.*

- *Arthur Cox Solicitors review / opinion of the implications for both the firm and all investors arising from their analysis of all correspondence / documentation relating to the Mezzanine Bond.*
- *Full details of how the firm calculated the return of monies to both the Mezzanine Bond and Non-Mezzanine Bond Investors in respect of the Le Patio and Incentre SPVs. The details / calculations should clearly demonstrate how the process of 'pari passu' was considered and applied by the firm to the distributions made to the relevant parties.*
- *Notwithstanding the above, the firm must prioritise the submission of information relating to the review by MKO Partners and the return of monies in respect of the Le Patio and Incentre SPV's."*

CHC wrote to the Central Bank on 29 June 2011 [Inspectors Exhibit 18]. This letter *stated "the Firm is not in a position to provide a detailed plan as present as there is still outstanding items which is affecting the scoping of the timeline."* The letter went on the state with regard to the above bullet points:

- *"The Firm have received preliminary advice from both the Luxembourg and Danish lawyers however the Firm has reverted with queries in order to get more clarity around the issue. The Firm is still awaiting a timeline from the lawyers. Until the Firm receives this timeline it will be difficult to gauge the duration of the process"*
- *"Please find attached calculation of the contingent liability as reviewed by MKO this has been caveated by MKO subject to the opinion from Cox Solicitors".*
- *"Following the Firm's meeting with Cox Solicitors Wednesday 22 June, Cox cannot start their review until the firm receives the requisite information from the Danish and Luxembourg lawyers. They did advise however that depending on what advice comes from the overseas lawyers that it may be a lengthy process"*
- *"The firm has asked MKO to review the Le Patio figures and provide their opinion. This is to be carried out by 1st July 2011 and the firm will revert as soon as they receive same. Incentre figures will be submitted at this time.*

No additional correspondence on this issue has been received to date.

In addition to conflicting information in relation to the pari passu issue, CHC also submitted to the Central Bank conflicting information in relation to the shortfall in the

Mezzanine Bond. Figures received from CHC in March 2011, stated that the shortfall existing in the Mezzanine Bond was €5,135,580 as at end December 2010. [Inspectors Exhibit 19] However, figures received from CHC on 19 April 2011 stated that there was a surplus of €2,317,192 as at end December 2010. [Inspectors Exhibit 19]

Then, figures received from CHC on 20 April 2011 stated that there was a €0 shortfall as at end December 2010. [Inspectors Exhibit 19] Finally, the MKO calculation referred to by CHC in the second bullet point above states that there was a shortfall of €5,162,164 as at end December 2010.

#### **7.4 Conclusions**

In the view of the Inspectors

- (a) CHC invested the assets of clients in the Mezzanine Bond without proper authority from all clients and without giving proper consideration to the interests of all clients, including suitability of such investments for them.
- (b) CHC furnished incorrect and misleading information about the Bond to such clients and to the Central Bank.
- (c) CHC made such investments on an uncertain basis as to the ranking of the funds advanced on foot of the Bond as a liability of the companies to which the funds were advanced.
- (d) It furnished misleading information about such ranking to the Central Bank.

## 8. STOCKBROKER CAPITAL ACCOUNT (SUSPENSE ACCOUNT)

### 8.1 Introduction

A suspense account is an account for book keeping purposes used temporarily to carry receipts and disbursements or discrepancies pending their analysis and permanent classification. A suspense account operates on the basis that one side of the double entry recording a transaction can be posted to this account (a debit or a credit) until its correct destination is known. Ultimately, a suspense account should contain a nil balance after the proper transfer of transactions to the correct accounts.

The Inspectors became aware of an account used within CHC referred to as the 'Stockbroker Capital Account'. This does not correspond to any actual bank account, it is a reference used within CHC to describe a specific suspense account. Normally such a holding / suspense account which should be used on a temporary basis only. This account appears to have been used to facilitate some of the activities carried out within CHC in relation to unauthorised investments from client holdings to property funds and the reversing of these transactions in advance of statements issuing to clients showing fictitious cash balances. These activities are described in more detail in section B5 of this report in relation to 'Segregated Client Asset Accounts'. When monies are received from clients or paid out of clients' funds, the transaction may be booked to the 'Stockbroker Capital Account' until the full details of the transaction become available (i.e. purchase of equities, investment in fund, sale of units in a fund, etc). The account should always return to zero on a regular basis (i.e. within a few days of a transaction being booked to it).

A typical transaction flow on the CHC Stockbroker Capital Account would be:

Payment           - Debit entry to Stockbroker Capital  
                          - Credit entry to the bank account used for the payment

Once the payment is allocated to a specific fund or investment product, the next entry should be:  
                          - Credit entry to Stockbroker Capital  
                          - Debit entry to client's Euro Investment Account to reflect an investment

The opposite entries would arise in the case of a receipt.

The inspectors requested that KPMG specifically review holdings within the Stockbroker Capital Account.

## 8.2 Sworn Testimony to Inspectors

The following statements, including questions where relevant are taken from sworn witness testimony relating to this account:

### Testimony of Mr Harry Cassidy dated 19 July 2011

A. *And, as I said, over that weekend following the receipt of the letter from Appian, we have identified that, you know, these flagged accounts are approximately – I think the figure was exactly 50 and, of that 50, Graham and Liam have broken them down as to how many were discretionary and how many were other categories. Then they have a list called the 'Stockbroker Account', which I don't know has that been referred to you? [36:27-37:05]*

Q. Yes, it has. Maybe, you could describe how that account operated? [37:06-37:07]

A. *Well, that was a surprise to me because I didn't fully understand it, but it effectively incorporates these flagged accounts so that the transaction was passed across an account called Stockbroker Account, which denoted that there was an issue. So that is where they would back in and out the entry. But that incorporates those 50 clients. [37:08-37:14]*

Q. Did any real account actually exist or is this just a reference? [37:15-37:17]

A. *It's not an account in the bank accounting sense of the word, Noel, but it is just denoted that way so they could identify that there was an issue. [37:18-37:20]*

Q. Sorry, the name of such an account escapes me, but there is a word for... [37:21-37:23]

Q Suspense? [37:24]

Q. Suspense type of account, yes. [37:25-37:26]

A. *"Suspense" might be a good word. [37:27]*

### Testimony of Mr John Whyte dated 25 July 2011

Q. And I suppose I would like you just to tell me your understanding of how the physical transactions were undertaken on flagged accounts around the statement dates? [24:22-24:25]

A. *Okay. So on if the client, for example, has a six monthly report end December, end June each year, so in between the report dates the property asset, as such, is shown in the valuation report. So come end June there is "note Unity: Please contact Harry or Paul before issuing valuation report". So the client service area, which is under my control, but somebody from the client service team would ring up to the Finance Department to say can they back out X investment and show that as either stockbroker account or client cash account on the valuation? Then the report would be run on that date and then once the report was run then the investments would be shown back up the next day. [24:26-25:10]*

Q. The transaction was reversed the next day? [25:11]

A. *Exactly so the client then, so they, at that particular date then the valuation was shown, the stockbroker capital account, client cash account, then it would be reversed out to show then the investment until the next report. [25:12-25:16]*

**Testimony of Mr Liam O'Reilly dated 18 July 2011**

Q. Okay. Okay. So you are not aware of that anyway. [38:28]

A. *No. That's it. But the girls on that side were giving out about having the back stuff out. So we didn't directly do it, you know, but trying to do a valuation, oh, Paul has to get back to me, or Michelle or something. So, and there was issues about the fund that we couldn't process payments because there was money on stockbroker, and then you would see a note like you saw, Please contact Michelle or Paul. So we couldn't do a payment because somebody asked to put the money in stockbroker, and somebody says pay 20 grand from this guy's account, to go in and the money is not there. [38:29-39:11]*

Q. Right. And on stockbroker, what is the short-term for? [39:12-39:13]

A. *Suspense account, really. [39:14]*

Q. A suspense account. [39:15]

A. *It is a holding account. [39:16]*

Q. Right. Okay. And I know that there is no stockbroker actually involved, is there? [39:16-39:17]

A. *No. I don't know where "stockbroker" came from. [39:18]*

**Testimony of Ms Susan Fennell dated 22 July 2011**

Q. Okay. Could you describe what the stockbroker account was? [22:28-22:29]

A. *Basically a stockbroker account is really just a wash through account that if -- like, if you were setting up an account, if you were transferring all the stock across. [23:01-23:04]*

Q. Yeah. [23:05]

A. *You would be buying the stock in, in through the stockbroker and it would be just kind of -- then the other side would be your capital account, saying what your capital introduction of whatever stock, like, into it -- because you wouldn't have had -- your Merrion account wouldn't be set up at that stage. [23:06-23:11]*

Q. It's a suspense account? [23:12]

A. *Yeah. Like, really no money should be going -- you can show transactions coming in and out but no money should be sitting on that account. Like, that account should always be at zero. [23:13-23:16]*

Q. Okay. There would be a stockbroker account and a stockbroker capital account, was it two accounts? [23:17-23:18]

A. *There would be a stockbroker account and then the other side is the capital account, where there's the introduction of the money coming into the account. [23:19-23:21]*



- Q. Right. [23:22]
- Q. But there was no bank account to back up that, it was just an account. [23:23-23:25]
- A. *No, there shouldn't be -- there is no bank account.* [23:26]
- Q. So it was just an account in the firm? [23:27]
- A. *In the firm, yeah.* [23:28]
- Q. A suspense account. [23:29]
- A. *Yeah.* [24:01]
- Q. Okay. I suppose, I think we're aware of a lot of these ones and it's I suppose trying to get a handle on the best way to drill down into how much -- like, has a reconciliation been done internally on the back outs? [24:02-24:05]
- A. *Not to my knowledge. I haven't done anything now so I'm not sure if anybody has actually done it.* [24:06-24:07]
- Q. Right. [24:08]
- A. *But I certainly haven't done it.* [24:09]

**Testimony of Mr Graham O'Reilly dated 18 July 2011**

- A. *That added up to -- I think the grand total, including-- there is another sort of account, Stockbroker account, where that was 1.4 million, the Stockbroker account was. This is whereby clients had money leaving their back account, the pool bank account, and not booked anywhere. Just hit this Stockbroker account.* [20:18-20:23]
- Q. Right. [20:24]
- A. *And that was 1.4 million, and beyond all the other...* [20:25]
- Q. So in reality that account has nothing that was put into the property, I presume? [20:27-20:28]
- A. *It probably ended up that way, yeah. But it wasn't booked, it was just booked as money leaving their account.* [20:29-21:02]
- Q. Out of let's say - [21:03]
- A. *The client asset gross for the Destiny client savings. Money cashed -- they should have in account is gone, and all you can see is just transfer.* [21:04-21:06]
- Q. And this Stockbroker account, who are the signatories on that? [22:01-22:02]
- A. *Well, the Stockbroker account was just booking on our system.* [22:03-22:04]
- Q. Right. It wasn't a real account. [22:05]

A. *No, no. It was just basically, if you didn't know where the transfer was going, or you didn't know how to book a transfer...* [22:06-22:08]

Q. You put it into that? [22:09]

A. *You put it into that. So usually then, when you were going to do a client valuation or a property valuation, you would see the Stockbroker account, and you would have to query, okay, why is that there? It either needs to be reconciled or else you find out what is going on here?* [22:10-22:15]

Q. So that was like a page where things were just put in abeyance like? [22:16-22:17]

A. Yes. [22:18]

...

A. *And you leave it there for now, and you question it, okay, what is going on there .It was a holding account basically.* [22:20-22:22]

Q. Yeah. But it was a holding account on the system, it wasn't really even an account? [22:23-22:24]

A. *Yeah, yeah. Just in the system.* [22:25]

#### **Further on in the testimony of Graham O'Reilly**

A. *Well, what we have identified over the last couple of weeks is, we were backing up any Stockbroker issues we found, I did back up into when the actual money left the bank.* [30:10-30:13]

Q. Is this this Stockbroker holding account? [30:14]

A. *Yes, this holding account. So you see the man's money coming out of his cash account, and then we book it on the other side, and that entry would be Stockbroker.* [30:15-30:17]

...

Q. Right [30:18]

A. *So I looked into exactly when -- when did this transfer actually go out of the bank.* [30:19-30:20]

Q. Right [30:21]

A. *How much was it for. And in a couple of them you would find out that about say 400 grand was transferred on that day across to Germany, but it was booked under 12 accounts split up under 12 accounts.* [30:22-30:25]

Q. Okay [30:26]

A. *So obviously these 12 accounts were covering that transfer.* [30:27-30:28]

Q. Right. Okay [30:29]...

A. *And then you would have another occasion where one client needed to get certain invoices paid. This would have come across over the last two weeks, now, and his cash wasn't on his*

*cash account when it should have been. He had obviously investments that should have been booked there, so you would need to get his cash from somewhere else, back into his account to pay his invoice. So you could see bookings on other accounts, money going out, and then your man would have his money again on his side, and then he would pay the invoice. So that that would be a prime example of that. [31:01-31:11]*

### **Testimony of Mr Paul Lavery dated 19 July 2011**

Q. The actual transaction that would have taken place between the statements. So say at one statement date, there was 200,000 in cash and then at the next statement date there wasn't and a property transaction had taken place, I am just wondering how that property transaction would have been processed?[12:25-13:01]

A. *On their client account? [13:02]*

Q. Yes? [13:03]

A. *Effectively, it was either shown as an investment on their account, buying into the property, or it was put in as a Stockbroker Capital Account. [13:04-13:06]*

### **8.3 Forensic Examination by KPMG**

At 23 August 2011, the balance in the Stockbroker Capital Account is €48.2m and as of that date balances were held in respect of 145 different clients and investments. [KPMG Exhibit 15] This is made up of €12m of negative balances (credit balances) and €60.2m of positive or debit balances. The following are examples of transactions in the Stockbroker Capital Account:

#### *Example 1*

A payment of €25,000 was made from the CLIENT 26 client ledger account on 23 August 2009. [KPMG Exhibit 16] A credit was posted to the Client Asset Gross Bank account, and a debit posed to the Stockbroker Capital Account. This transaction was routinely backed out when issuing valuations so that client continued to see €25,000 in cash. However, this entry was never corrected and remains held in the Stockbroker Capital Account.

KPMG were unable to identify the beneficiary of the €25,000 payment amount. KPMG identified an email relating to a payment out of the Client Asset Gross Bank account on 24 August 2009 for €25,000 in relation to commission due to Harry Cassidy and John Mulholland paid to a bank account name H Cassidy/J Mulholland in Luxembourg. [KPMG Exhibit 17] (see also Luxembourg Account section C17 of this report in relation to this matter).

### *Example 2*

The CLIENT 47 Trust account was showing a negative balance of €3.3m on the Stockbroker Capital Account as at 25 August 2011. [KPMG Exhibit 18] The nominal ledger indicates that €3.2m is held in various investment products. Emails exist indicating that the investments listed on Unity as held on behalf of the CLIENT 47 Trust have been encashed. [KPMG Exhibit 19] This has not been recorded on the nominal ledger which still records the funds as being held in those products. The debit side of this entry was to transfer the funds in three tranches to the ARF Management Client Current Account but the credit side of these entries was posted to the Stockbroker Capital Account. By posting the credit entry to the Stockbroker Capital Account the nominal ledger does not record the encashment of the investments held. It would therefore appear that the negative balance of €3.3m relates to funds owed to the CLIENT 47 Trust.

### *Other issues*

It is possible that some of the entries posted to the Stockbroker Capital Account relate to unreconciled items which may clear as reconciliations take place, however a full reconciliation is necessary to assess whether the clients showing balances on these accounts are or may be at a loss.

KPMG reviewed a number of emails to the finance and IT unit from staff within the client services function of CHC where requests have been made to “back out the stockbroker” or “clear the stockbroker”, or analogous statements used, so that valuation reports could be run. [KPMG Exhibit 20]

KPMG also reviewed a number of emails to Harry Cassidy, or copied to Harry Cassidy, where issues with the Stockbroker Capital Account and client accounts are raised. In one email from Michelle Donnelly to Harry Cassidy dated 17 August 2010 she states: [KPMG Exhibit 21]

*“These funds should all be part of the list of funds used that paul gave you before he left. In total circa 16.6m. instead of funds being in a property its just on stockbroker.”*

An email dated 14 January 2011 [KPMG Exhibit 20] from Susan Fennell to the finance and IT unit states:

*“Money on Stockbroker A/c can you please do your magic”*

## 8.4 Conclusions

As a general accounting matter, the use of a suspense account should always be minimised and the clearance of items in the suspense account should take place regularly so that credibility can attach to the underlying accounting and financial records. The longer it takes for the clearance of suspense accounts suggests that items therein recorded are not properly recorded or cannot be properly recorded. A practice of regularly and consistently using suspense accounts facilitates the maintenance of inappropriate accounting and financial records.

It is clear from a review of the items contained in the CHC 'Stockbroker Capital Account' that this account was being operated as a suspense account with the deliberate intention to conceal the true nature of transactions processed by CHC from the relevant client. More specifically the CHC 'Stockbroker Capital Account' was used to facilitate some of the activities carried out within CHC in relation to unauthorised investments from client holdings to property funds and the reversing of these transactions in advance of statements issuing to clients with fictitious cash balances.

## 9. QUALIFYING INVESTOR FUNDS

### 9.1 Introduction

Custom House Capital Investment Property Funds plc (CHC Property) (company number 422825) was incorporated on 29 June 2006. It was authorised by the Central Bank on 25 September 2006 as a qualifying investor designated investment company under Part XIII of the Companies Act, 1990. A qualifying investor fund is a non-UCITS collective investment scheme which markets to institutional investors and high net worth individuals.

CHC acts as promoter and investment manager to CHC Property. The directors of CHC Property are Harry Cassidy, John Mulholland and John Whyte. Bank of America Custodial Services Ireland Limited (Bank of America) acts as the fund's independent custodian and LaCrosse Global Fund Services (Ireland) Limited (LaCrosse) provides administration services. Bank of America and LaCrosse are authorised and supervised by the Central Bank in relation to the services of the nature that they provide to CHC Property.

CHC Property has two sub-funds, CHC Prime Property Fund 1 which was approved by the Central Bank on 25 September 2006 and CHC Prime Property Fund 2 which was approved on 16 May 2008, but which it is understood has not commenced business.

The Central Bank sought clarification in late 2010 from CHC in relation to subscription monies of €2,884,600 that had been raised for investment in CHC Prime Property Fund 1 being placed on deposit with a large French property developer. CHC did not proceed with the initial property development identified in France (which was called "Moretti") however the monies have remained with the French developer since 2008. CHC has continually represented to the Central Bank that this amount of €2,884,600 related to money being held on deposit for the purchase of a new property. Information which the Central Bank has received more recently, on 17 June 2011, indicates that the original agreement with the French developer allows for it to retain all of the deposit monies. By letter from Mr Cassidy dated 17 June 2011 CHC represented to the Central Bank that it had received verbal assurances from the developer that it would not take this course of action meaning that it would not retain the deposit monies. [Inspectors Exhibit 20]

On 15 July 2011 the Central Bank, being of the opinion that it was in the public interest and in the interest of the proper and orderly regulation of the funds, imposed a direction on CHC Property requiring it to suspend all principal activities.

The Central Bank is also investigating other issues in relation to the operation of CHC Property which include:

- (i) The delay in the launch of the sub-funds and whether CHC had a mandate to purchase the properties on behalf of investors prior to the launch of the sub-funds,
- (ii) The delay in transferring title of the SPVs and control of the underlying properties to Bank of America, as independent custodian
- (iii) Other general issues, namely:
  - Financing of the SPVs
  - Fees paid to CHC in relation to property transactions
  - Sale of properties in the SPVs and treatment of sale proceeds
  - Possible incorrect valuations of the properties within the SPVs.

## 9.2 Sworn Testimony to Inspectors

The witnesses called by the Inspectors were asked about the operation of the CHC Property sub funds. The following statements, including questions where relevant, are taken from sworn witness testimony relating to CHC Property:

### Mr Maurice Harte on 11 August 2011

Q. Right, okay. I suppose, we have talked about the Mezzanine issue, the schedule, the valuations and the-- are there any other issues that you think you should bring to our attention that have come to light either during the time you were involved with the Property Committee or that the disclosure since then would now say, well, that's something I think should be looked at further or that may not be as I thought it was? [35:26-36:04]

A. *Well, I think the answer to your question is yes. The AGRI bond is another example of issues that come up.* [36:05-36:06]

Q. Yes? [36:07]

A. *But in terms of trying to respond, I think at a previous meeting here, I think I used the expression using a complete solution to what might happen going forward and I hold that view and I am saying that in the context of as much as possible and within the time available understanding -- and I am thinking clients here, I am thinking money flows -- what the real position is in terms of the issues raised by Appian, in terms of the issues raised by the Mezzanine Bond and, indeed, the Marseille Bond or other bonds that may be there, but also any other issues that may be here and I, again, based on experience, I have found that the more you start looking, unfortunately you have to assume that other issues will come up. To be specific in terms of your question, I would be concerned about the calculation, for instance, of*

the NAV on the QIFs because that depends on values and everything else and the position there. I would be concerned about the method of holding of certain investments and how they are being held and by who and under what mandate or control. And I would be... [36:08-36:28]

#### Further on in the evidence of Mr Maurice Harte

Q. Certain property deals or transaction, I think we are aware, didn't actually proceed for one reason or another. I think one that calls to mind is Incentre. I don't know whether you're aware of that one, Maurice, but, irrespective of that, are you aware of any situations whereby CHC would have kind of engaged in a property transaction that didn't proceed and what happened then on... [43:16-43:24]

A. I'm aware I think it's Moretti in particular where there is a -- I am just trying to get the numbers right in my head here, but I think there's 2.8 million monies that -- this did come up because it came up in the context of various matters. I think that money is now within the QIF or supposed to be in the QIF. What it was was that it was money that was to be used to develop a property in Marseille with a company called La Bouygues. That didn't go ahead and those monies are still with La Bouygues and my understanding is that what would have happened is that CHC in some shape or form entered into a development/contractor's agreement with this company, which is a development company -- it's a construction company, I think -- and then that didn't go ahead and, as part of the arrangement, a percentage would have been paid in advance to secure the contract and, again, I would have indicated at the time of the last couple of weeks that somebody should really meet with La Bouygues to try to secure whatever can be secured there. I was also conscious of correspondence with yourselves in relation to that money and certainly the impression I would have got from your correspondence is that you felt it was money that was being held on deposit. My view is that it's deposit, but not in the context of deposit with a bank. It's money placed on deposit to secure an overall contract for the development of a property and I think -- I haven't seen that contract, but I think that should be looked at. And provided the company is reputable -- where this has happened before, in my experience, normally some recovery can be achieved. However, for the purposes of producing any information here, I think you would have to take the assumption that that money might be difficult to recover. [43:25-44:29]

#### Mr Finn O'Connell on 18 July 2011

Q. Have you any observations to make on that issue? [46:07]

A. I am sure they are no different to your own. Like, it's -- you're also aware -- another example would sort of be the Maranplatz and the Swiss properties (both phonetic), you know. And we have this ongoing issue with the Bank of America as the trustee to that fund. If the money is there, give me the bank account details, statements or other proof and that makes all the problems go away, and Bouygues is the same thing. If it is as you say it is, that that money is being held in deposit and can assessed or returned be at any time, then just give me a letter that says it.<sup>31</sup> [46:07-46:16]

Q. Right. [46:17]

A. I mean, I won't lie to you. I am not comfortable sitting and reading this with yourselves or anybody else, where it is sort of being proposed that you know, well, it is client money and we will get it back, where again, no<sup>32</sup> documentation that I have seen to date hints at anything like that. [46:17-46:23]

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<sup>31</sup> Text has been deleted and underlined text has been amended from the verbatim transcript by the interviewee

<sup>32</sup>Text has been deleted and underlined text has been amended from the verbatim transcript by the interviewee.



**Ms Leslie Coulter on 26 July 2011**

Q. Okay. So you didn't come across issues that you couldn't get a satisfactory explanation of them... [15:12-15:14]

A. *No mine would have been more, for example with the QIF, when Marienplatz or when Bern & Thun was sold I could not get an answer to where the money was so, or where the money is gone or anything. So that is where I would have had all of my concerns, well you cannot sell a property and not know where the money is. So mine was sort of more sort of collectively, you know? So if you sell Bern & Thun there was four million, well where is the four million and where is the evidence? Well they said it was in such and such a property, show me it, but we don't have it, well if it is there you should have the documentation. So it was more sort of well where groups of money was as opposed to individual investor's money. [15:15-15:28]*

Q. Right and did you get a satisfactory answer to that, to those questions? [15:29-16:01]

A. *No, I still haven't, I still haven't but I flagged it as far as, I mean I flagged it, I started sort of bypassing Harry and went straight to Sean. [16:02-16:04]*

Further on in the evidence of Ms Leslie Coulter

Q. But if you were looking for the documentation, as you said, to back up who would you be asking for it? [22:07-22:08]

A. *John Whyte, Paul and Deirdre Canavan. [22:09]*

Q. And did you very rarely get the documentation? [22:10]

A. *I never got, never got it, I have never got back-up, and the back-up that I have got, you know, would have been a spreadsheet. That is the answer but it wouldn't have been verified against anything and maybe would have been -- you know when I ask to see a bank account I expect to see the bank statement on headed paper confirming, it would have been no, no that is our figures, there is the number. [22:11-22:18]*

...

A. *But that was them doing it and I just would never, I was just like no I am not, I am not sending that. Especially Bank of America for the QIF were asking for money and I was just like I don't have that information, and I am not sending you a spreadsheet that says they think it is there, because if it is there the bank account should show it. [22:20-22:26]*

**Mr Harry Cassidy on 2 September 2011**

Q. Right. In relation to the QIFs themselves there seems to be a lot of confusion over what is held in the QIFs or what isn't held in the QIFs and indeed whether the second one was launched properly or not, what are your observations on that? [40:12-40:16]

A. *Well, I think I said it at the last interview I had with you, we had significant difficulties getting trustees and custodians for the QIFs. We had been led to believe and had it on strong authority that Bank of Ireland security services were going to act as our trustees and custodians. we then spent an inordinate amount of time and fees trying to establish exactly how they would take security of the assets that were going to be held to the extent that they then turned around and said, "oh, well, we don't like that. We don't know how to hold property and we are not going to act." And we were left literally high and dry. And then we*

*approached I think Northern Trust Bank and halfway during the discussions with them they got taken over or taken out or the people we were dealing with got laid off and we were left high and dry a second time. And then Bank of America or whoever was the forerunner of Bank of America stepped in. [40:17-41:05]*

Q. Hmm [41:06]

A. *So, I am not surprised it's a bit of a mess because it's just been difficult from the very outset. And in doing what we were doing and having made commitments to various properties we couldn't stop those. So whilst the structures weren't set up properly we had to continue with the purchase of the properties. So QIF 1 to a certain extent was done more accurately than QIF 2. QIF 2 hadn't been launched because Bank of America then got uptight about the documentation around QIF one and refused to have a, give us a price for QIF 1 -- or QIF 2 until QIF 1 was resolved. And that just made it very difficult to be able to report to people still having to report to people as to what the launch price was, even though we were committed on the properties. [41:07-41:20]*

Q. Right. And how much money was taken in for QIF 1 and QIF 2? [41:21-41:22]

A. *QIF 1 was to the order of about 55 million. [41:23]*

Q. Yes. [41:24]

A. *QIF 2. I am, somewhere in the order of about 28-30 million. We had intended raising more but we didn't, so we only ended up then acquiring one property which was the Issy-les-Moulineaux property in Paris. And that is the only property currently held in QIF 2. [41:25-41:29]*

Q. Is there one property or two properties there? [42:01-42:02]

A. *It's two buildings, but effectively one portfolio. It's the same tenant, it's just the buildings are split by a narrow road. One building is the administration and the second building is the sort of executive suites, they are different but let to the same tenant. [42:03-42:07]*

Q. Right. And in relation to the 55 million and 28-30 million is it -- can those be clear, can those subscriptions be clearly identified with the particular investments or those monies used to finance other properties that wouldn't be reflected? [42:08-42:13]

A. *Well, I think Noel would bear testament to this, this has been the subject of very, very detailed, lengthy and laborious discussions between CHC and yourselves. we made a very substantive submission to you prior to Christmas, I think it was last year, setting out exactly what we had raised in QIF 1 and exactly where those monies had been placed. That raised several other queries as to what money was in or wasn't in the likes of Pleinouest and Le Patio, but it was pretty clear to us where those monies are and were, so I don't think there is any debate around that. It's a bit easier in QIF 2 because there is only one or the two properties, depending which way you look at it. You know, there was the intention and there was the issue around, as you are aware from other issues outside of this report, the Morretti<sup>33</sup> deal and the deposit that was placed on that which was intended to be part of QIF 2. [42:14-43:02]*

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<sup>33</sup> Underlined text has been amended from the verbatim transcript by the interviewee

### 9.3 Forensic Examination by the Central Bank

#### CHC Prime Property Fund 1 ("CHC 1")

From information in returns provided to the Central Bank by CHC Property, CHC received subscription monies from 166 investors totalling €55,528,900 for investment into CHC 1. It is not clear exactly when CHC received the subscription monies but LaCrosse, the administrator, received application forms for subscription into CHC 1 between September 2008 and January 2009. All application forms were signed by CHC as nominee for each underlying investor.

The normal procedure when making investments into a collective investment scheme would be to pay the subscription proceeds into an account maintained by Bank of America as custodian for CHC 1 and shares would be issued to the investors or to CHC as nominee for the underlying investors. Property investments would then be purchased by the fund and Bank of America would take custody of these assets.

CHC did not pay the subscription proceeds received from investors into CHC 1; instead the monies were used (together with bank borrowings) to purchase 5 European properties in Germany, France and Switzerland through SPV structures. According to CHC the properties could not be acquired directly by the fund due to tax and legal issues in relation to the transfer of title to the property assets to Bank of America as custodian for the fund. CHC also claimed that they were permitted to carry out these transactions on behalf of the investors by the terms of the investment management agreement signed by each investor.

Details of the 5 properties acquired by CHC on behalf of investors are as follows:

Property	Location	Purchase Date	Purchase Price (approximate)	December 2009 valuation (approximate)
Jungfraustrasse 1	Berne, Switzerland	30/03/2007	€5.4 million	€5.5 million
Bernstrasse	Thun, Switzerland	30/03/2007	€4.5 million	€3.4 million
Maximillian Centre	Woerth am Rein, Germany	31/03/2008	€71.9 million	€68.1 million
Le Patio	Marseille, France	24/11/2008	€26.5 million	€19.2 million
Plein Ouest	Marseille, France	12/02/2009	€30.6 million	€22.2 million

In December 2009 CHC 1 was formally launched by way of an *in specie* transfer of three SPVs into the fund based on current market value of the underlying properties and shares were

issued to investors. The three SPVs included the two French and two Swiss properties. The German property, Maximilian Centre, did not transfer into the fund due to unfavourable tax treatment of rental income. Amounts totalling approximately €2 million were retained by CHC in pooled client accounts for the payment of marketing fees owed to CHC. The effective date for the issue of shares was June 2008; there is no explanation as to why this date rather than the actual launch date of December 2009 was used.

The most recent information filed with the Central Bank by CHC 1 states its current net asset value to be €18.9 million but this figure does not take account of a sale in 2010 of the Le Patio and Swiss properties and it is not yet known what proceeds from these sales after repayment of bank loan etc. will be paid into the fund.

A payment of €1.3 million was made to CHC out of the proceeds from the sale of Le Patio which represents 5% of the original purchase price of €26.5 million. The prospectus for CHC 1 provides for the payment to CHC of a property acquisition fee of up to 5% of the value of any property acquired by the fund. The fund did not acquire the property related assets until December 2009 when CHC 1 was launched and shares issued to investors. Therefore the acquisition fee paid to CHC in relation to Le Patio and the other properties should be based on the December 2009 value of €19.2 million rather than the purchase price. It appears that CHC was only entitled to a payment of fee in the amount of €985,000.

#### **CHC Prime Property Fund 2 (“CHC 2”)**

CHC received subscription monies from 75 underlying investors totalling €30,477,006 for investment into CHC 2. It is not clear exactly when CHC received the subscription monies but LaCrosse, the administrator received application forms for subscription into CHC 2 between December 2009 and July 2010. All application forms were signed by CHC as nominee for each underlying investor.

CHC did not pay the subscription proceeds received from investors into CHC 2; instead the monies were used (together with bank borrowings) to purchase 2 properties in France through SPV structures:

<b>Property</b>	<b>Purchase Price (approximate)</b>	<b>Current Market Value (approximate)</b>
Panorama Seine	€76.1 million	€67.1 million
Dockside ilot	€21.4 million	€17.2 million

CHC may be due marketing fees in the amount of €3.8 million in relation to these acquisitions. According to the terms of the prospectus the property acquisition fee of 5% is only payable on the value of properties acquired by CHC 2. CHC 2 has not launched, no assets have been transferred into the fund, no shares have been issued to investors, and therefore the exact amount of the fees due cannot be determined, nor is it clear on what basis CHC has accrued these fees.

## 9.4 Conclusions

### CHC 1

The Inspectors are of the view that the operations of CHC 1, under the control of CHC as promoter and investment manager, require further investigation in order to establish the following:

- Full details of how the total subscription monies received from investors are accounted for in relation to purchases of properties, payment of fees and expenses and total commissions paid to CHC.
- The reasons for the delay in the launch of CHC 1 and whether CHC had a mandate to purchase the properties on behalf of investors prior to the launch of CHC 1.
- The delay in transferring title of the SPVs and control of the underlying properties to Bank of America, as independent custodian.
- The procedure followed for the *in specie* transfer of assets into the fund and the issue of shares to investors and why a retrospective launch date of June 2008 was used.
- Full details of how the total subscription monies received from investors are accounted for in relation to purchases of properties, payment of fees and expenses and total commissions paid to CHC.
- Full details of the transaction involving the placing of a “deposit” of €2,884,600 with a French developer.

The Inspectors are of the view that there is a serious doubt as to CHC’s entitlement and ability to recover the deposit monies. These doubts are compounded by the difficulty experienced in obtaining clear information from CHC in relation to this issue.

In the view of the Inspectors the status of this “deposit” was continuously misrepresented to the Central Bank and CHC has failed to supply clear information on its status.

## CHC 2

The Inspectors are of the view that the operations of CHC 2, under the control of CHC as promoter and investment manager, require further investigation in order to establish the following:

- Full details of how the total subscription monies received from investors are accounted for in relation to purchases of properties, payment of fees and expenses and total commissions paid to CHC.
- The reasons for the delay in the launch of CHC 2 and whether CHC had a mandate to purchase the properties on behalf of investors prior to the launch of CHC 2.
- The delay in transferring title of the SPVs and control of the underlying properties to Bank of America, as independent custodian.

## **10. CLIENT MANDATES AND TRANSACTION PACKS**

### **10.1 Introduction**

For the purposes of ensuring that transactions are carried out in accordance with the clients' instruction and authority CHC must be in a position to demonstrate that appropriate documentation exists to support the transactions it processes on behalf of its clients. Regulation 100 of S.I No 60 of 2007, the European Communities (Markets in Financial Instruments) Regulations 2007, states that an investment firm shall establish and maintain a record that includes the document or documents agreed between the firm and its clients that set out the rights and obligations of the firm and the firm's clients. Sworn testimony given indicated that CHC did not maintain adequate records in respect of client mandates, and that certain client mandates were left blank and not signed. The practice of deliberately manipulating records for the purpose of issuing misleading client statements (see section B12) suggests that the processing of certain transactions on behalf of clients was both contrary to the authority given to CHC by clients and without the clients' knowledge.

By direction issued by the Central Bank on 18 June 2010 and renewed on 17 June 2011, CHC was directed 'not to conduct any transaction on behalf of a client of CHC in any investment, including all property related investments, without the prior completion of a written confirmation by two persons designated by the Financial Regulator', being senior persons in CHC; the designated persons from time to time included the non-executive chairman of CHC, its head of operations and its head of compliance.

CHC's Compliance Officer confirmed that transaction packs received for review were often returned because the documentation supplied was insufficient to determine that the transaction was appropriate for the client. The purpose of transaction packs was to ensure that all appropriate documentation existed for a client prior to any transaction being effected for the client. Where documentation supplied in the transaction packs was deficient the transactions should not receive approval to proceed.

### **10.2 Sworn Testimony to Inspectors**

The witnesses called by the Inspectors were asked to identify circumstances where transactions were undertaken or attempted to be undertaken, in breach of the direction first imposed by the Central Bank on 18 June 2010.

The following statements, including questions where relevant, are taken from that testimony and/or written statements:

**Mr Paul Lavery on 19 July 2011**

- Q. Are you aware of a transaction that would have gone through post the transaction pack process being put in place? [14:12-14:14]
- A. *More recently, there was the transactions done from one of the equity fund -- it was the PRSA equity funds. And that was there towards the end of -- I think it was last September/October last year<sup>34</sup>. [14:15-14:18]*
- Q. How much was that for? [14:19]
- A. *Top of my head stuff, I don't know. I think it was about 5 or 6 million, maybe, something like that, 7-10<sup>35</sup>million. [14:20-14:22]*
- Q. So to be clear then, Paul, are you saying that, as far as you are aware, there wasn't a transaction pack for that transaction? [14:23-14:26]
- A. *Correct, yes.[14:27]*
- Q. Do you have any knowledge as to how that transaction came about or who processed it? [14:28-14:29]
- A. *That transaction was done effectively by -- Harry instructed John Whyte to process a number of trades on the account and then a transfer was then instructed by Harry to go out to specific properties that it was going to, effectively. Harry would have sent an e-mail to where the funds were going I would have sent an email to Harry to approve the transfer<sup>36</sup>. [15:01-15:10]*
- Q. So you got an e-mail approving it over an objection? [15:11-15:13]
- A. *Yes, I would not do anything unless I raised my concerns with him and got him to approve anything that was done. [15:14-15:16]*

**Further on in the evidence of Paul Lavery:**

- A. *Because, you know, we always assumed that the investment that he had chosen, that the clients, that they were legit and it was only more recently, I was just thinking about it last year, Harry asked me to look at an investment and I done up a schedule up and said, 'Listen, these clients, these are investments made and these are accounts that cash was used-- but, listen, these are not all discretionary', you know, that sort of a way. Then I went through client accounts myself, checked through client documentation... [33:26-34:06]<sup>37</sup>*
- Q. When did that conversation take place? [34:07]
- A. *That was last August before I went on holidays... [34:08]*

**Further on in the evidence of Paul Lavery:**

- Q. If you can, please let us know. Just going back to the conversation in August, at that stage, was it not -- I suppose, were alarm bells not ringing that the accounts being chosen by Harry weren't discretionary? [35:20-35:23]

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<sup>34</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>35</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>36</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>37</sup> Text underlined has been amended from the verbatim transcript by the interviewee



A. *Alarm bells were ringing all the time, to be honest with you. I have always raised concerns with him and, I suppose, like, the reason he said he would sort them out and he would deal with it and he would resolve the accounts, you know, and I suppose it was always in the back of my mind that I placed my trust in him and I always thought at the end of the day that he would do the correct thing and resolve the issues. But, you know, I always said, listen, give him time to resolve them, but it just kept going on and on and on. [35:24-36:04]*

Q. Did you ever raise your concerns with any of the other directors? [36:05-36:07]

A. *I spoke on a number of occasions to John Whyte about it and he had similar concerns and went to Harry about it too on numerous occasions. I suppose you don't know who to go to. You go to your main boss and you assume that he is going to resolve these issues. [36:08-36:12]*

**Mr Harry Cassidy on 19 July 2011**

Q. Well, maybe going back to the more general question then, when the crunch happened and your commitments to putting up more equity fell away, how were those shortfalls generally met? [14:17-14:21]

A. *Well, I think the shortfalls were generally met by clients that I understood at the time were discretionary -- it is later shown that not all of them were -- and some of their funds were used for that purpose. [14:22-14:26]*

Q. So, just to understand, you are saying that some funds from client accounts that you believed at the time were discretionary were used to fund shortfalls? [14:27-14:29]

A. Yes. [15:01]

Q. Can I just ask then, Harry, how did you understand that they were discretionary? Like, I mean, what did you do to satisfy yourself that the authority was there? [15:02-15:05]

A. *Well, what I would normally do is advise somebody else, Paul or John or whoever, that we had a need for half a million or a million or whatever the figure might be and were the funds available to meet that. I would get either a yes or no and, if I got a yes, then those funds would be transferred to a German solicitor or French solicitor or whoever might be involved. [15:06-15:12]*

Q. But did that include checking the authority that there was, say, a discretionary mandate in place? [15:13-15:14]

A. *Well, I wouldn't have checked it personally because I wouldn't do those sort of things. That wasn't my role. I don't have access directly and never have had to the Unity System or to the Therefore System. It was just preferable that I didn't, you know, for authorisations, that it would come from other people other than myself. So I wouldn't check on Unity or I wouldn't issue reports. [15:15-15:22]*

Q. So are you saying that you wouldn't have checked that the accounts that were being debited were...? [15:23-15:26]

A. *Personally, I wouldn't have checked. I would have asked, but personally I wouldn't have checked. [15:27-15:28]*

Q. You would have asked. Who would you have asked? [15:29]

A. *I would have asked John Whyte or Paul Lavery or whoever is involved in that. But, normally, it would be John because he would be dealing with the clients, and then Paul in terms of the transfers. [16:01-16:04]*

Q. What information then would you have received on foot of that request from those people? [16:05-16:07]

A. *I'm presuming I would have received an okay that there was cash there to be used. [16:08-16:09]*

Q. And that the mandate was there also. That is, I think, what we are more interested in? [16:11-16:13]

A. *I don't know whether I would have got specific wording around that, George. I am not being vague, I just don't know that I would got -- because I am not too sure I would have asked was there a mandate for that. I would have asked was there cash available from discretionary clients to invest. [16:14-16:19]*

Q. Can you indicate when the latest of those transactions were put through? [16:20-16:21]

A. *Well, the latest would have been probably May of this year. I might be out by a couple of weeks. [16:22-16:23]*

Q. And how would that tie in then with the requirement to prepare the transaction package for each of these transfers? [16:24-16:26]

A. *Again, I don't know because I don't do the transaction packs and I wasn't signing off on them. [16:27-16:28]*

Q. But for those transactions that you may have asked was cash available, are you aware that those transactions, even as late as May this year, did go through the transaction pack process? [16:29-17:03]

.....

Q. For those transactions that you got information on that the cash was available and, as you say, up to as late as 2011, May of this year, do you know that the transactions ultimately went through the transaction pack process? [17:05-17:17:09]

A. *I think just for me to clarify for you, the last -- George asked me when was the latest or the most recent transfers and I would have said May, April or May, those monies would have come from the Destiny equity fund, so not directly from a client portfolio. So, therefore, there wouldn't have been a transaction pack around that... [17:10-17:16]*

#### **Mr Finn O'Connell on 18 July 2011**

Q. So a direction was issued to the company whereby this transaction pack had to be produced in advance of all transactions being processed? [7:11-7:13]

A. *Yeah. And so to answer your question, was I aware of anything untowards, I would have to say I wasn't. And I think that is, in hindsight, probably a potential flaw which I think has sort of surfaced in the last couple of weeks, that you know, you could circumvent that process by simply processing a transaction, particularly where people who are initiating or authorising those transactions could be, for example, Client Services and Finance. But what was supposed to happen, again, my understanding was, and this was part of the directive, (A) and (B)*

would have been acknowledged by the directors that any transaction to be affected on any client account should have gone through that process. [7:14-7:28]

Q. So just for clarity again, are you saying that well, some of the transactions didn't go through that process and that is how the... [7:29-8:02]

A. Well, I guess based on my understanding of what has been discovered by Appian, and subsequently complained to yourselves, that there were transactions where client funds were - let's use the phrase "**misallocated or misappropriated.**" I would not have been aware of a transaction where, you know, Noel Thompson had a quarter of a million Euro in cash in his account and that that was what we authorised the transaction to move though that to a particular property without the backup on file. That, as I said again, the transaction was occurring within either discretionary mandate, or with the express instruction of the client under execution or advisory. [8:03-8:15]

#### **Further on in the evidence of Finn O'Connell**

Q. I am still very confused, I suppose, by a transaction wouldn't be processed unless it was in line with the mandate, yet we have a situation of 30 to 40 million being... [64:18-64:21]

A. And I think that the point I was making at the start, which is, clearly there was a separate process where those -- that directed process, I -- based on the directive from the Central Bank was being superceded, undermined, circumvented, whatever, whatever explanation you want to use. [64:22-64:27]

#### **Ms Suzanna Cummins on 08 August 2011**

A. I mean, again, in doing those -- and, I mean, at times, there was some heated conversations with Harry and, in cases, John Whyte where I wouldn't process one of the transactions because I didn't feel that we had sufficient back-up documentation. But I think once they understood the reasons, they were -- they weren't happy about it, but they understood the reasons for doing it and the documentation was obtained. There was no transaction packs that -- actually, on the property side, one of the issues that did come up was the fact that some of the payments to that had to be made to the properties from the cash accounts. I was concerned there was no standing instruction on the investors' files to allow those transaction to happen without going back to the client to ask their permission and none of those were allowed to be transacted unless we did get permission from the client. [21:20-22:07]

Q. Is there any way of identifying at this remove which ones you would have said 'No, those can't go through'? [22:08-22:09]

A. Oh, actually, you could probably see that. We kept a register of all of the transactions that were made and we kept a date of when it was submitted for sign off and you can see the date it was submitted and the date that it was actually approved. Hopefully, that register was maintained. But even looking at the back-up documentation packs, I would have note... [22:10-22:17]

Q. Where would that register have been maintained? Who would have maintained it? [22:18-22:19]

A. It was maintained by the compliance team. It was Aisling Barrett and Sean... [22:20-22:21]

A. Sean Carolan, thank you, Sean Carolan that would have maintained that. [22:23-22:24]

Q. Are you aware, Suzanna, if any transactions were, in fact, put through without the transaction pack and subsequently the transaction pack had to be put together or...[22:25-22:29]

A. No. [23:01]

Q. ...circumstances like that? [23:02]

A. *Well, no, I remember at the time when the directive was issued, we spent a lot of time going down through transactions that were due to happen and certain circumstances and I had insisted on writing up a letter and submitting that in to the Consumer Department and saying -- and I think Noel got a copy of the letter -- 'These are the situations which we have' and for various cases which ones we were allowing the transactions to go through and the reasons for that. But I was never aware of anything that was transacted that was done outside of that approval process. [23:03-23:13]*

#### **Ms Leslie Coulter on 26 July 2011**

Q. Yeah. Are you aware of situations where the transaction packs were not completed, or of transactions that were carried out without the transaction packs having been- [5:25-5:27]

A. *I am now. [5:29]*

Q. Yes. [6:01]

A. *But not at the time. [6:02]*

#### **Further on in the evidence of Ms. Leslie Coulter**

Q. Right. In the time since the 21 March have you become aware of other transactions that maybe you have come across in a similar way, without the transaction pack? [9:06-9:08]

A. *There has been a few correspondence came in. Now I don't know the details of them because they didn't come my way. [9:09-9:11]*

A. *Where, especially through Irish Life and Permanent that it just seemed that paperwork has come in to confirm and it has gone upstairs to John Whyte and then, I have sort of, we have sort of said this needs a transaction pack, why has that gone through without a transaction pack?, it doesn't need one. Yes it does, everything needs a transaction pack. Oh well I will put one together. So there has been about five to ten of those. [9:13-9:20]*

A. *That sort of, they came in in the post, the post comes down to me and I am like what is this? I go back up to client services, well we didn't need a transaction. Yes, you do need a transaction pack, and then they put one together so they have sort of done it... [9:22-9:27]*

Q. Retrospectively? [9:28]

A. *Backwardly as opposed to coming through compliance first and getting it, getting it signed off and then the other one would have been... [9:29-10:02]*

Q. And would that have been signed off then by yourself or would they have been signed off elsewhere? [10:03-10:05]

- A. *It depends. It would come my direction, whether it did in that? I think maybe two questioned have come back down and they would have held the rest of them. [10:06-10:08]*
- A. *But then we would have blocked the accounts on those. [10:10]*

**Further on in the evidence of Ms. Leslie Coulter**

- Q. In relation to mandates, Leslie, like client mandates; whether they be execution only, advisory, discretionary, did you come across issues or concerns which you had on that front? [41:27-42:02]
- A. *Yeah. That would have been, because they would have accompanied the transaction packs and it would have been a daily preaching session of if it is advisory you need to give us the advices given, which never accompanied the transaction pack. This would mostly be directed at John Whyte. He just was very much yeah no but sure just put it through. You know he would be -- I described it as Groundhog Day because you go in and you preach all day, then you get up the next morning and you would swear you never said what you had to say again. Mostly with advice, the advisory would have been a problem; that we never got the advice and when you sent it back we would have got like a one liner, obviously made up there and then on the spot, and it was just like that is not good enough. I mean I would just be like send it back, I am not accepting it. So, yeah, that would have been -- John Whyte would have been a big problem with that<sup>38</sup>, the others not so bad. Like the likes of Ciara and Rob would have been pretty good on their packs. [42:03- 42:22]*
- ....
- A. *But you got -- I questioned John Whyte's every day. [42:27]*
- A. *And he would have been very much just, oh just do it it is urgent<sup>39</sup>. [42:29]*
- Q. And would you have a concern that something was being put through more on a discretionary basis than the mandate would have allowed for? [43:02]
- A. *Yeah. [43:03]*
- Q. And in terms of the firm's records, would there be records of everybody's mandate available somewhere within the... [43:07-43:09]
- A. *They are all, they are incomplete. So there might be, I mean Noel Thompson may have a mandate signed and not filled in. So to them they have a mandate on file but it is useless because it is literally a signature. There was a big documentation review done where we brought in an external party to do it and it is not pretty reading. That would have formed the Appian list of clients primarily. [43:10-43:17]*
- Q. When you say "it wouldn't make pretty reading" is that a report from the external party? [43:18-43:20]
- A. *No, basically what they did was they went through the entire client base. [43:21-43:22]*

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<sup>38</sup> Mr Whyte disagreed with this statement. Having regard to the considerations outlined at paragraph 1.13 above, the inspectors have not been able to form any conclusion in relation to this.

<sup>39</sup> Mr Whyte stated that he endeavoured to have transaction packs up to date and in order and, where necessary, retrospectively brought into order. Having regard to the considerations outlined at paragraph 1.13 above, the inspectors have not been able to form any conclusion in this regard.

- A. *And said what their mandate, what their IMA said, were they discretionary, executionary, were they an intermediary client, a direct client? [43:24-43:26]*
- A. *So what type of client they were? Were they compliant or not compliant, you know? So basically did they have an up-to-date file? [43:28-44:01]*
- A. *And I would say very, very little of them did. [44:03]*
- A. *And then there was meant to be, so Phase 2 of that was client services team was meant to go and get everything updated. [44:05-44:07]*
- A. *I mean even one example is the Mezz transaction packs outstanding from February. [44:09-44:10]*
- A. *One has been completed. [44:12]*
- A. *One. And that, I mean that is the subject of a sanction. [44:14-44:15]*
- A. *So you would think, you would like to hope that, I mean I know if I had a sanction against me I would be doing everything in my power to sort it out. One in, what, six months has been, has been completed. [44:17-44:20]*

**Ms Ciara Kelleher on 22 July 2011**

- Q. *I suppose, if we start from one end and say if we take it as a fact that he -- I am just using CLIENT 2's name here, but it could be anybody's name but, in similar circumstances, if it is a fact that they are in a property -- in this case, perhaps, Munich Parkstadt -- it should have only occurred following the production of a transaction pack... [48:27-49:04]*
- Q. *...which would have identified in this particular case that it was outside the requests or mandate in the IMA or the PRSA application or whatever? [49:06-49:08]*
- A. *It couldn't have gotten that far, George, that's the whole point, because the start of a transaction pack, it wouldn't even be that you would get as far as with a transaction pack and review it and go 'Oops, I don't think this was right'. It couldn't have gotten that far because you would have to start with the client's authorisation and you wouldn't have had that. So you wouldn't have even gotten as far as submitting a transaction pack. [49:09-49:17]*
- Q. *So if you are to come to a conclusion... [49:18]*
- Q. *Come to a conclusion how it actually has happened, is it that in your opinion then no transaction pack could have been done... [49:21-49:23]*
- A. *Correct. [49:24]*
- A. *It couldn't have been done because you can't do a transaction pack without the client's request. [49:26-49:27]*
- A. *Well, actually, I lie there -- well, I don't lie. You could actually do a transaction pack on a discretionary account where you believe it's in the client's interest to do something. You could actually have the discretion over the account, technically speaking, but I have never done that. Even on accounts where the client has filled out a discretionary and ticked "discretionary", technically speaking CHC can invest accordingly. But one client springs to mind and he is ticked as discretionary and I would still have checked with him and I would have still had it on e-mail and on the phone and notes recorded that he wanted his monies moved. You just*

wouldn't have done it without checking with the client. So there is no way that that could have started with a transaction pack because my transaction pack was out there asking for something else to be done. [49:29-50:16]<sup>40</sup>

Q. Did CLIENT 2 in that case, did he have a discretionary mandate? [50:17-50:19]

A. No, I think he's advisory but I can check that -- it's on Therefore. But it's irrelevant, really, what he's ticked because people change their mind the whole time. It's knowing your client, and I know the client, and he didn't like property. He did his property, his thing, years ago and he did well. He got out of our property years ago and he did well and he got out when it was good and he had no interest in going back in, none. [50:20-50:27]

Q. Would it be a case, though, on a discretionary mandate where other areas would be processing transactions, that they would decide, well, a transaction pack isn't required? [50:28-51:03]

A. No, they wouldn't be making that decision for him. They couldn't say 'Oh, well, I think it's a discretionary and I'll put that forward'. The only people who would be putting that forward would really be me or John. [51:03-51:07]<sup>41</sup>

#### Mr. Sean O'Dwyer on 8 August 2011

Q. Yes, one issue that we discussed before, Sean, transaction packs and when they were introduced and the sign offs, did any issues ever arise on those, do you recall? [26:22-26:26]

A. No. I mean, sorry, I won't say it was plain sailing. There would have been issues with -- and, I suppose, I would get involved if, say, I think it was Finn and Suzanna probably were the main signatories, so if one of them was away then, they would come to me or whatever. There was a process which involved, you know, what was the transaction, what did the IMA say, was the client ID'd and all of that kind of stuff. So Aisling Barrett, who worked for Suzanna and then for Anne, would have prepared a pack of stuff and so she would either go through that with me or whoever she was asking to sign the packs. Now, there would be issues from time to time that I would hear, but this was after the event, that, you know, somebody was looking to have a transaction approved and they didn't have all the documentation and Aisling or Suzanna or whoever it might be would say 'Well, we are not signing that' and it would be held up and then somebody might be giving out because something was delayed. But it was very clear, you know, you had to have all the documentation there and the proper documentation. So there were issues like that which were sort of day to day operational type issues with it. But stuff was only signed off when Aisling confirmed she had all the information. Now, I know there were a few property ones that got signed off, not these properties ones we're talking about here, but more property where a loan payment had to be made or something like that out of the rental income<sup>42</sup> and there was confusion at one point where I think we thought we had approval to make those and then we discovered subsequently we didn't have approval. So, in that interim period, 20 or 30 had been processed without a proper approval. So Suzanna or whoever it was was going back and getting the approvals for those ones done retrospectively. I don't know if it actually did happen completely. I presume it did, but I can't be a 100% sure. So that was the only problem that we would have had with it, you know, was those property ones, which were all relatively minor payments from memory. [26:27-28:08]

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<sup>40</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

<sup>41</sup> The interviewee later stated the following : "Harry, John Mulholland, Ruth and the broker team (Neil and Rob) would all be processing clients investment decisions alongside John Whyte and I but they too would need to go through compliance: Harry and EPT would normally submit request to John or I to handle via compliance and Neil/Rob would submit directly".

<sup>42</sup> Underlined text has been added to the verbatim transcript by the interviewee

### **10.3 Forensic Examination**

A forensic examination was not carried out specifically of client mandates or transaction packs required to be completed as per the initial direction to CHC of 18 June 2010. However the forensic examination by KPMG did examine transactions as set out in previous sections of this report that occurred in segregated client accounts, client cash funds, client equity funds and pooled accounts. The testimony above indicates that certain transactions referred to in those sections were effected without a correct mandate or being in compliance with the directions imposed on CHC from 18 June 2010.

### **10.4 Conclusions**

The Inspectors are of the view that certain transactions may have been conducted on behalf of clients without either a correct mandate for these transactions i.e. CHC having discretionary power to make transactions on behalf of the client; or a transaction pack having been prepared and approved, as required by the directions issued.

It is clear to the Inspectors that transactions were processed where there was insufficient documentation to meet the terms of the directions issued.

It is also clear to the Inspectors that the breach of the investment mandates that CHC held with clients (as can be seen from section B2 of this report, Destiny Cash Funds), when CHC caused very substantial amounts of clients' Cash portfolios to be invested into property, represented a breach of primary conduct of business obligations.



## 11. DELAYS IN PROCESSING CLIENT REQUESTS

### 11.1 Introduction

The CHC Client Services team regularly received requests from clients to return or move cash amounts and other assets being held on their behalf. Several staff members from the Client Services team outlined to the Inspectors how it was becoming increasingly difficult to get these requests processed in a timely manner and that the backlog of such requests was rising in recent months. In one particular instance it was outlined that a request for cash to be processed for a client was outstanding since March 2011 but the client was informed the transaction was completed when it had not. The Inspectors were informed that delays in processing client requests for cash were not isolated incidents and were spread across various aspects of CHC's business.

### 11.2 Sworn Testimony to Inspectors

In this regard, the following statements, including questions where relevant, are taken from this sworn witness testimony:

#### Mr Paul Lavery on 19 July 2011

Q. Are you aware of any significant delays in meeting client payments? [24:09-24:10]

A. *To be honest with you, more recently, there would have been some delays.* [24:11-24:12]

....

A. *Mainly in the last few weeks there in relation to guys moving out of PRSA and then they'd be coming looking for cash and the cash wasn't there.* [24:14-24:16]

Q. Where was the cash supposed to be? [24:17-24:18]

A. *Supposed to be in the fund, cash, you know.* [24:19]

Q. In one of the Destiny funds? [24:20]

A. *Yeah, Destiny appears in cash, yes. That was a main cause of it that we got people transferred out to different entities.* [24:21-24:23]

Q. They were looking to take altogether...[24:24-24:26]

A. *Correct, or to transfer the pension to a new provider, Aviva or New Ireland or whatever the case may be.* [24:27-24:28]

- Q. In those circumstances, Paul, what actually happened? Was it the case that the payment never went to the client? [24:29-25:02]
- A. *Correct, a lot of the payments haven't -- there's probably a backlog of payments there. I was talking to Liam yesterday and it's about 10 or 15 payments that haven't been completed yet. There is nothing I can do about it. The guys were on chasing me about it and I am chasing Harry and saying 'These are the issues here, Harry, and you need to resolve them'. [25:03-25:09]*
- Q. And is there no money to pay them? [25:10-25:11]
- A. *Correct. [25:12]*
- Q. How much is it at the moment? [25:13]
- A. *At the top of my head, I wouldn't know. There is so many of them going through. I don't know what the figure could be. It could be a few hundred thousand<sup>43</sup>. I still have two cases where it's probably about 114,000 between two individuals. [25:14-25:18]*
- Q. Has there been delays in the past as well where there hasn't been enough money? [25:19-25:21]
- A. *Not so much in the past. It was just more recent here because people had moved out and any cash (inaudible) gone effectively. [25:22-25:24]*
- Q. What would the clients be told? [25:25-25:26]
- A. *I don't know, I don't have any dealing directly with the clients, you know. So the guys in the Client Service directly go to them and say 'Listen, where is the transfer?' and they say -- I don't know, to be honest, what line they'd say to them, I don't know what they'd say. [25:27-26:03]*
- Q. Are you aware of any instance where, maybe, cash or assets received from the clients was used to discharge the requests or instructions on others? So you were getting in cash or assets from one guy, were they being used in...[26:03-26:08]
- A. *Effectively, let's say, for instance, to give you an example, each individual in there has their own pension, a PRSA, and we do a transfer in every month from our salary. That money would then be transferred into the PRSA cash fund, right, and let's say somebody else came along and said 'Listen, I want my money out' and if there was cash in the cash fund it would be used to pay out<sup>44</sup> (inaudible) everybody would be used to pay it. [26:09-26:16]*
- Q. So, for example, to meet some of these, 15 guys are waiting in the queue? [26:17-26:18]
- A. *That's correct. [26:19]*
- Q. So your own fund was being used as well? [26:20-26:21]
- A. *Everybody's PRSA, yes. [26:22]*

**Mr Liam O'Reilly on 18 July 2011**

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<sup>43</sup> Underlined text has been added to the verbatim transcript by the interviewee

<sup>44</sup> Underlined text has been added to the verbatim transcript by the interviewee

Q. Okay. In relation to the delaying, then, of the delay in raising finance against invoices, are there being delays in paying out to clients? [29:27-29:29]

A. Yes. [30:01]

Q. Okay. And could you be more specific on that? [30:02]

A. *We -- we have an inbox that is called the fund out and in box. Basically I helped set it up a year ago because people -- we had loads of internal transfer requests, and instead of sending an e-mail to Joe or somebody, I said just send it to the central inbox. It would all go through the one box.* [30:03-30:08]

Q. It's just an e-mail account? [30:09]

A. *It's just an e-mail account. There is a number of transfers in there, and we have to move -- myself and the team just can't process because there is nobody in the accounts. The clients are invested in the PRSA cash fund and...*[30:10-30:14]

Q. How many requests are there that are unable to be filled at the moment? [30:15-30:16]

A. *It could be 15. I don't have a monetary amount.* [30:17]

Q. And are these clients who, their statements -- they think they have money in their account? [30:18-30:20]

A. *Yeah, and they could have an investment in PRSA cash fund, the PRSA cash fund. Maybe he doesn't have the money because it is invested in property.* [30:21-30:23]

#### **Mr Finn O'Connell on 18 July 2011**

Q. In relation to -- if, for example, clients were complaining they weren't getting their payments or they had asked for their payments a month ago and they are still waiting, would those types of queries go to you? [17:23-17:27]

A. *I mean, there may have been some that were escalated to me, but again, I would have escalated them separately, both to Harry Cassidy and Paul Lavery.*[17:28-18:01]

#### **Mr Leslie Coulter on 26 July 2011**

Q. Are you aware, Leslie, of deliberately delaying or frustrating the transfer of client money to the clients over the last three or four months? [40:16-40:19]

A. *Yeah, yeah we would have had. Certainly some of the transactions that have come down, something like the client that we asked you guys about around about the very beginning there, and I have come across two more through letters written in, on the 21st July, sort of saying I asked you to transfer this money ages ago.* [40:20-40:25]

....

A. *And I mean again they would try the, there even as recently as two or three weeks ago they would have said compliance held that up, we never signed it off, and it is like no, no there you go, it was, it was signed off the day you gave it to us and then, you know, the internet banking excuse was used, that it had fallen down and...*[40:29-41:06]

Q. Right. [41:17]

A. *...there was at least three I would be aware of...* [41:08-41:09]

Q. Right. [41:10]

A. *...where they weren't transferred, money wasn't transferred.* [41:11-41:12]

Q. And would they have been mostly requests for withdrawals or transfers of accounts or - [41:13-41:14]

A. *Yeah and some were, I think one was definitely a transfer out.* [41:15-41:16]

Q. Right? [41:17]

A. *And it was a sizable amount of money and it wasn't, it just wasn't done.* [41:18-41:19]

**Mr Neil Bowes on 26 July 2011**

Q. Okay. Well one set of questions really, it is about essentially requests from, from your clients and others for transferring their PRSAs, closing their accounts, getting money out of their accounts, have you encountered complaints from your, your clients about delays in getting those done or have you.....[50:10-50:15]

A. Yes. [50:17]

....

Q. And what is the nature of those complaints? [50:20]

A. *As you said they are complaints about the time it takes to get something sorted, done and dusted. That has been an ongoing issue ranging from commissions paid to the broker, who has introduced that million quid through their clients, haven't been paid.* [50:21-50:25]

Q. Right. [50:26]

A. *It could be a year or two years down the line. That would typically be the concerns that would get pointed towards me because I am responsible for those relationships.* [50:27-51:01]

Q. Right. [51:02]

A. *And that is why I have taken most of the flack. In relation to the more recent work that I would have done in terms of monies being paid out or clients transferring their business to another-* [51:03-51:06]

Q. Yes. [51:07]

A. *And that has been a big, you know there has been quite, as you will have seen, movement of clients out from Custom House Capital during the kind of inertia.* [51:07-51:10]

Q. Yeah. [51:11]

....

A. *And, em, yes there were always delays.* [51:20]

....

A. *You kind of almost, it didn't, you know it is kind of accepted, you just kind of accepted it. Well, you know, somebody said well that shouldn't take more than a couple of weeks, should it, and you knew very well it wasn't? But that's, unfortunately you just had to, you know there was no point in shouting about it. [51:24-51:29]*

#### **Ms Ciara Kelleher on 22 July 2011**

A. *Well, the big one is CLIENT 2 because that hasn't moved since March. But there would be... [31:25-31:27]*

Q. *What excuses would have been given for the delays or what reasons? [31:28-31:29]*

A. *He doesn't know that it's not done or he didn't know until I rang him 14/7 after ye came in 13/7 and I said that there's a problem. [32:01-32:03]<sup>45</sup>*

Q. *But if you were following up on the issues with Harry or Paul...[32:04-32:05]*

A. *Oh, for the reasons? [32:06]*

Q. *What reasons would be given to you? [32:07]*

A. *I'd just get stonewalled. No reasons, just silence. [32:08]*

Q. *Right? [32:09]*

A. *Just a head in the sand. [32:10]*

### **11.3 Conclusions**

The Inspectors are of the view that there were significant issues with CHC responding to requests from clients to move cash amounts and other assets held on their behalf. There were certain instances where a valuation statement may have gone out to a client showing an investment in a particular property in error which obviously caused concern for the client who then could have requested their money to be transferred to another firm. As appears in other sections of this report there was a widespread practice within CHC of money being taken from accounts where there were positive cash balances in order to meet the redemption amounts due on other accounts. However in recent times due to both an increase in clients exiting CHC and redemption requests there was an increase in cash requirements and as such the length of time between requests and payments increased.

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<sup>45</sup> Underlined text has been added to the verbatim transcript by the interviewee

## **12. CLIENT STATEMENTS AND REVERSING TRANSACTIONS**

### **12.1 Introduction**

In relation to each client where cash had been improperly taken by CHC to fund property investments a 'pop-up' or 'flag' would be inserted onto the relevant account held on CHC's customer relationship management system, 'Unity'. When CHC needed to generate a Client Statement the 'pop-up' would appear requesting the staff member to refer the matter to senior management.

The staff member would normally contact the Finance team who would supply data for entry onto the account. This would include for instance a reversal of the property transaction and re-insertion of a cash balance and a fictitious accrued interest amount. The Client Statements would then be run, and when completed the property transaction would be reinserted.

Thus representations were made to clients, through the provision of incorrect statements which did not correctly reflect how the clients' funds had been used or invested, that his/her cash balance was accruing interest as normal where in fact the client's cash had been used for property transactions.

### **12.2 Sworn Testimony to Inspectors**

A range of questions concerning this aspect of CHC's operation was put to all of the witnesses called before the Inspectors. Consequently there is a lot of testimony given on this subject. The following extracts have been chosen to clearly illustrate how this operated in practice and those who were centrally involved.

#### **Ms Susan Fennell on 22 July 2011**

Ms Fennell was a long standing employee of CHC and more recently worked in Client Services dealing with the production of 6 monthly and 3 monthly valuations for clients, reporting to Ciara Kelleher and thereafter John Whyte.

Ms Fennell indicated that when she was running valuations a 'pop-up' would appear on some accounts. In relation to the 'pop-up' she said that it:

A. *...literally just was a pop-up that came up on Unity. So all it said was "contact Paul and Michelle" on it. So I queried about it and I was told it's okay, just go with it. [10:14-10:17]*

In the period up to November/December 2010 Ms Fennell described how, when a 'pop-up' appeared on an account, she would:

A. *...have automatically sent an email to Paul and Michelle [8:19-8:20]*

She indicated that Paul Lavery or Michelle Donnelly

A. *...would have come back then and said that valuation is okay to run and I would have actually just gone with what they had said and ran it. [8:22-8:24]*

Ms Fennell then stated that from November/December 2010

A. *...I actually don't know why but Paul actually started coming to me then. I think Michelle just said she wouldn't back out and so Paul came to me. So he gave me then the -- he gave me the batches to delete and then the interest. But I wouldn't back out anything until I got the okay from everybody. So, like, I was only going on instruction on that. [8:25-9:03]*

Ms Fennell was asked to describe the process and replied:

A. *.... so just say somebody could have been in, just say, Destiny 140, which was a property fund in Spain. [9:10-9:12]*

A. *And I would have just deleted that transaction. [9:14]*

A. *...Paul would have given me the interest accrual on that earning. [9:22-9:23] ...So overall his interest, his bank interest would have been shown correctly on the system.. [9:24-9:26]*

A. *So I would have ran the valuation then, ran it all off and then when I was finished then put back in the transaction then into the Destiny 140, but leave the interest accrual then as what it should be. [9:29-10:03]*

According to Ms Fennell those accounts with the associated 'pop-up' would normally show an investment in a property (or a Stockbroker Capital Account issue – see section B8). Prior to issuing a valuation the property purchase and related cash transfer showing on the account would each have been reversed out. Ms Fennell, having been supplied with an interest accrual reflecting what should have been earned on the cash deposit had it in fact been on deposit, would have entered it and proceeded to generate the valuation showing the cash amount and the interest accrual. This would then be sent to the client.

When asked if she had raised any concerns, when she was asked to do these reversing transactions, she stated

A. *I discussed it with John Whyte...I said it to Paul Lavery...Ciara was in my presence when I did say it to John Whyte [12:14-13:02]*

According to Ms Fennell that "backing out" would be related to:

A. *...either a stockbroker issue or it was a property issue [22:26-22:27]*

Ms Fennell confirmed that the stockbroker account in question acted like a suspense account and

A. *...basically the stockbroker account is really just a wash through account... [23:01]*

#### **Mr Harry Cassidy on 19 July 2011**

On the issue of the flagged accounts, Mr Cassidy stated that:

A. *I think it states on it to contact me or Paul Lavery [31:25]*

While Mr Cassidy added

A. *I don't recall any instance when I was contacted [31:26]*

When asked how long he was aware of the reversing of client transactions on client statements, he replied:

A. *I would have known about it for a couple of years [30:16]*

When asked whether he had sought to rectify this situation, he stated that of the 80 clients referred to by Appian there were

A. *probably about 50 because I think it certainly had been rectified over some period of time [30:27-30:28]*

Of those 50 clients Mr Cassidy stated

A. *I identified about 14 to 18 that were discretionary and another 18 or so were advisory and then a bunch that came under the category of 'Others' and I still have yet to find what others mean [31:08-31:12].*

Mr Cassidy was asked if clients, who had cash moved from their accounts to property where such a transfer was not in accordance with their investment mandate or objectives, were contacted. Mr Cassidy stated:

A. *No...because... there was very little we could do about it [33:02-33:03]*

When asked if other staff members raised their concerns to Mr Cassidy, he confirmed

A. *John Whyte and I would have had discussions about it, John Whyte, Paul and myself but no others [32:06-32:07]*

Mr Cassidy stated that this system of reversing transactions on statements started "at the back end of 2008 into 2009" [34:28-34:29]. When asked who suggested it, Mr Cassidy said "I would have to take responsibility for it because I am the CEO" [35:04-35:05]. He also stated that "I allowed it to continue" [35:21].

When asked if the issue of the client statements being altered was ever brought to the attention of Suzanna Cummins of Compliance, Mr Cassidy replied:

A. *No...and I didn't bring it to the attention of any person who subsequently came into that role [72:08-72:09]*

When asked whether the Client Asset auditors were informed that incorrect client statements were being issued to clients, Mr Cassidy said: "it's pretty obvious that it probably should have been but it wasn't". [65:08-65:09]

### **Mr Paul Lavery on 19 July 2011**

When asked about flagged accounts [6:12] and what they were for, Mr Lavery replied that:



A. That was essentially in order to keep track of where there may be issues on client accounts.[7:15-7:16]<sup>46</sup>

Q. What sort of issues?[7:17]

A. Effectively, like, if a client's investment was on an account that was incorrect, that was mainly it. So let's say, for instance, like, the client had five thousand in cash and that cash was effectively put into a property when it should not have been, that's why there was a note on the system to identify that. [7:18-7:23]<sup>47</sup>

Q. And that would be put into property without the customer's knowledge? [7:24-7:25]

A. Correct, yes. [7:26]

Mr Lavery indicated that having ‘..looked at some stuff last week there and I reckon is probably about between -- 60 to 80..’ [8:19-8:21]<sup>48</sup> When asked when this practice had started he said ‘ to be honest with you, it's going back a few years now .’ [9:07] but gave a wide range, stating that ‘back to 2003 or, more recently, 2007/2008 onwards.’<sup>49</sup> [9:12]

Mr Lavery confirmed he had concerns about this process and that he had expressed these concerns to Mr Cassidy stating:

A. I voiced my concerns to Harry on numerous and numerous occasions<sup>50</sup> [10:05-10:06]

#### **Mr John Whyte on 25 July 2011**

Mr Whyte gave an example of how reversing transactions on client accounts took place:

A. So... if the client, for example, has a six monthly report end December, end June each year, so in between the report dates the property asset, as such, is shown in the valuation report. So come end June there is ‘note Unity: Please contact Harry or Paul before issuing valuation report’. So the client service area, which is under my control, but somebody from the client service team would ring up to the Finance Department to say can they back out X investment and show that as either stockbroker account or client cash account on the valuation? Then the report would be run on that date and then once the report was run then the investments would be shown back up the next day”. [24:26-25:10]

When asked if he made the staff in his section aware of why these reverse transactions took place Mr Whyte stated:

A. ... no absolutely not [40:16]

It was put to Mr Whyte that the net effect of this whole process was that the clients were receiving statements that were erroneous, Mr Whyte replied:

A. Yes absolutely, I am not denying it.” [42:3].

#### **Mr Liam O'Reilly on 18 July 2011**

Mr O'Reilly, when asked about valuations on client accounts being flagged, stated:

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<sup>46</sup> Text has been amended from the verbatim transcript by the interviewee

<sup>47</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>48</sup> Text has been amended from the verbatim transcript by the interviewee

<sup>49</sup> Text underlined has been amended from the verbatim transcript by the interviewee

<sup>50</sup> Text has been removed and amended from the verbatim transcript by the interviewee

- A. *...client asset recs were done... and we would run the system but the balance had changed. So we would flag that with the finance department and say why did the balance change...And the finance department -- usually it was Michelle... would ring and say can you run it now.* [38:18-38:27]

**Ms Suzanna Cummins on 08 August 2011**

Ms Cummins, a former Compliance Officer (from 26 August 2009 to 30 September 2010) when asked if she was aware of accounts that had specific pop ups or flags, stated:

- A. *There was actually one account that I couldn't actually access...I asked Paul about it and I said 'Why can't I see the details on this account?' 'Oh, Harry has blocked the transactions on that account because the client has concerns with confidentiality',....There are pop-ups and notes being used on the system, some that might say something like 'Don't issue a statement to a client'. When I queried any of them, I had gotten an answer that was reasonable.....I mean, it was things like 'Oh, the fee on the account, we have to collect fees on the account'.* [28:23-29:13]

When Ms Cummins was asked whether she had had any cause to compare account statements that had been issued versus what the accounts were actually saying on the Unity system?

- A. *No.....One of the things that was always surprising was that they checked all of the statements before they went out and it took an exorbitant amount of time. The reason for doing that, I was told, was to calculate the fee and that there was always, you know, some errors in postings by Paul and we needed to check them all to make sure they were okay before they went out.* [30:07-30:15]

**Mr Sean O'Dwyer on 8 August 2011**

When asked about the issue of incorrect client statements being submitted to clients, Mr O'Dwyer stated:

- A. *I'll just use the word "inappropriate", and they are clever enough and there is a few people colluding, because it seems pretty clear there were at least three people that were involved in that* [15:08-15:11]

Mr O'Dwyer also stated:

- A. *Whether Harry had direct knowledge of it I don't think matters, direct knowledge that they were flagged doesn't matter. I mean, these were clearly accounts that had different assets to what they were supposed to have and, therefore, the statements didn't get sent out without Paul and I presume, maybe, it was Paul primarily because I don't think Harry, actually, would have been able to manipulate the system because I don't think he would have known how to do it* [18:12-18:20]

**Ms Aleksandra Szelong on 22 July 2011**

Ms Szelong when asked what she knew about the client pop ups, stated:

- A. *In my understanding it would mean that these accounts have to reviewed by the Finance team before I can issue the valuation to the client* [21:04-24:06]

Ms Szelong was asked whether she had questioned why property was posted on client statements, where the client should not have been invested in property. Ms Szelong stated:

A. *I think there were a couple of, maybe, instances that the clients were showing a property investment that I questioned or somebody else questioned. [22:26-22:29]*

When queried who reconciled such accounts, Ms Szelong stated:

A. *If it was on my desk, I probably would send an e-mail to Ciara, my manager, talk to her, try to solve the situation. [23:04-23:07]*

### **Ms Ciara Kelleher on 22 July 2011**

Ms Kelleher stated that the flags on client accounts meant that:

A. *...the girls on my team...would send an email to Paul and Michelle and ask them for clarification [7:14-7:15].*

She added that from her understanding:

A. *...the finance team would back stuff out, we would run the report and they would back stuff in [8:01-8:03].*

Ms Kelleher also stated

A. *You can't do anything until you get the ok from Paul [29:04-29:05].*

## **12.3 Forensic Examination by KPMG**

KPMG's investigations in the records of CHC disclosed a number of emails relating to the execution of reversing transactions on client accounts and the knowledge of various individuals within CHC [KPMG Exhibit 33]. These include (each email below appears in KPMG Exhibit 33):

One email from Michelle Donnelly dated 21 July 2009 to the clients services staff (John Whyte, Ciara Kelleher, Zara Mulholland and Susan Fennell) stated:

*'I have put notes on unity in relation to some clients as a pop up. ....' An example of the text on the pop-up for those specific clients was given as 'Please contact Harry or Paul before issuing any valuations (interim or 6 monthly) to anyone – MD'*

An email from Ciara Kelleher dated 12 July 2010 to Paul Lavery, Michelle Donnelly and John Whyte on the subject of 'Procedures around temporary bookings on client accounts – URGENT' states:

*'Hi Paul,*

*We need to review the procedures around these “Temp Asset Bookings”. Instead of the pop-ups stating to contact PL/HC before issuing valuations, we should have the detail of the transaction that needs to be backed out eg “€425k in Allemanic needs to be reversed into Cash when issuing client valuation”. Then at least the team know what is not a valid booking instead of chasing internally in vain. We also need to have a procedure akin to the Mezz accrual bookings where Cash that is temp booked elsewhere has the interest accrual calcs saved centrally that can be booked to unity at valuation time again without having to refer to you.*

*This will give the team the autonomy to reverse and reenter bookings and get the valuations issued improving the turnaround times. The current system is not sustainable and is leading to a huge amount of frustration all round. Would need to start by getting a listing of all these “temp bookings”.*

*Can we discuss?’*

An extract from an email from Ciara Kelleher dated 8 September 2010 to Harry Cassidy, and cc’d to John Whyte, Finn O’Connell and Paul Lavery, on the subject of ‘Reports & Invoices’ contains the following;

*‘... e.g. CLIENT 22 and CLIENT 10’s cash is supposed to be in PTSB to avail of higher interest rates. Since these transfers have not been completed, there is no point sending the reports in the knowledge that the client will phone straight back up asking why not.*

*As discussed previously, I would suggest doing interest accrual postings for any of these accounts for what they would have earned if we had transferred the money, so at least we can sign off the reports and issue the invoices. Same issue where the client’s funds are in Incentre or some other assets and we get them backed out for the purposes of the report. ...’ (emphasis in original email)*

## **12.4 Conclusions**

In the view of the Inspectors, both from the testimony received and a review of relevant accounts and the content of extensive numbers of emails, the practice of falsifying client statements through the deliberate and temporary removal of property investment purchases from clients’ accounts was pervasive within CHC.

### **13. ARF MANAGEMENT LIMITED**

#### **13.1 Background**

The matter of ARF Management Limited (“ARF”) and its connection with CHC and property investments promoted by CHC first arose in the context of testimony given to the Inspectors by Mr Harry Cassidy on 19 July 2011. The Inspectors understand, based on this testimony, that ARF is a company currently owned and controlled by Mr Cassidy. We understand that John Mulholland and Ruth Woods, who are married to each other, and John Whyte were previous shareholders and directors of ARF. It has been represented that the company was originally set up with the intention of conducting pensioner trustee business but subsequently effectively lay dormant. The Inspectors understand that Mr Mulholland, Ms Woods and Mr Whyte have resigned as directors and that Mr Cassidy’s spouse, Elena Cassidy, has become a director of the company.

ARF conducts trustee business, which is not a regulated financial service, and it is not authorised or supervised by the Central Bank. The provision of trustee services is regulated by the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010. ARF as such has not been investigated in the course of the Inspectors’ investigation of CHC. The material set out below reflects matters which have come to the Inspectors’ attention and which bear directly upon properties into which funds, both properly invested and misallocated funds, of CHC clients have also been directed. The Inspectors have not made any finding with respect to ARF or the individuals directing that company.

ARF was incorporated on 8 July 1999, company number 309337. The registered office is 9 Merrion Square, Dublin 2, the same office as CHC, whose facilities and staff were made available to ARF.

#### **13.2 Sworn testimony**

The following statements, including questions where relevant, are taken from sworn testimony and/or written statements given to the Inspectors.

##### **Mr. Harry Cassidy on 19 July 2011**

In the course of an Examination under Oath on 19 July 2011 Mr Cassidy was asked to explain the relationship of CHC with ARF.

Q. Could you explain what the relationship with that particular company is? [79:07-79:08]

- A. ARF Management Limited is a company controlled by me. [79:09]
- ..... when we were planning the breakup of CHC and I was, you know, obviously going to be surplus to requirements, certainly to Appian and probably to Signature eventually, then I would have wanted a home where I could work out of. So I got John and -- the two Johns who were shareholders and Ruth to sign over their shares to me in ARF Management Limited because it had no value. [79:21-79:28]
- Q. And does it have any value? Does it do anything at the moment? [80:01-80:02]
- A. Well, it does small business. What I have is about two years ago Bank of Ireland Trust Services made it their intention they wanted to get out of the trust business, which is trusts established under wills, and they were looking for somebody to step in and they approached us. I am not too sure how they did, but they approached us as to whether we would be interested in taking that business. We decided to set it up through ARF Management Limited because it fitted into that and there are about 23 or 24 trust clients in there. They are all, say, ex Bank of Ireland. A lot of them are very small and they pay quite small fees. But I just saw it as an opportunity for me to have some form of a company that I could operate out of and build on if I wanted to do any advisory services or anything else that I wanted to do. [80:03-80:18]
- Q. What kind of value would the total of the trusts amount to, do you know? [80:19-80:21]
- A. About 7 or 8 million.[80:22]
- Q. Are any of those in the property?[80:23-80:24]
- A. Yes, two of them are. I have full discretion on those, and there is two of those trusts are in. They are very long-term trusts. Well, you know, if you are familiar with trusts -- that's where I started my life many, many years ago in the Bank of Ireland myself in the Tax and Trust Department. So these are trusts established under wills and they go on in perpetuity. So they only wind up on the death of the last surviving spouse of King George V blah blah, so it means they never end. So they have certain beneficiaries and we've got to make payments to them, which we do, and so a couple of those -- only two<sup>51</sup> of them have invested in the properties. Do you want the names of them?[80:25-81:08]
- Q. Well, if you have them?[81:09]
- A. The CLIENT 48 trust, the CLIENT 47 trust and...[81:10]
- A. [INITIAL] for CLIENT 47. Off the top of my head, I can't think of the other one. I'll have to come back to you on that.[81:13-81:15]
- Q. When would those trusts have invested in the... [81:16-81:17]
- A. Very recently, in May. [81:18]
- Q. So what value for those particular ones that are in the SPVs, or the properties?[81:20-81:22]
- A. About 3.5 million or 3.8 million.[81:23]
- Q. Would they not have been regarded as new customers?[81:24-81:25]

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<sup>51</sup> Text underlined has been amended from the verbatim transcript by the interviewee

- A. *Well, they are not customers of CHC.*[81:26]
- Q. They are investing directly?[81:27]
- A. *That's ARF Management, yeah, they are not customers of CHC. We kept them separate because what I didn't want them is transferring with Appian because it's my business, so they are not customers of CHC. They have no investment management agreements.*[81:28-82:03]
- Q. When you say you have full discretion, what does that mean?[82:04-82:06]
- A. *There are two appointed trustees, which is John Whyte and myself, and we have full discretion over the portfolios.* [82:07-82:09]
- Q. Like, you can invest where you like? [82:10]
- A. *We can invest where we like.*[82:11]
- Q. Do you consult with the people?[82:12]
- A. *Well, the only people we consult with is us because most of the beneficiaries are probably in some way indisposed.*[82:13-82:15]

**Mr. John Whyte on 25 July 2011**

Mr John Whyte also gave testimony on 25 July 2011 confirming that he had been a director of ARF but had resigned 2½ months earlier as he felt that role would conflict with his proposed move to Appian Asset Management. He confirmed that he remained a signatory to the ARF accounts but that this was being changed. He noted that the trusts gave wide discretion to the trustees but when asked as follows:

- Q. ... any funds ever transferred out of those, the trustees accounts, into property or anything else? [63:07-63:09]
- A. *Not into property as far as I am aware* [63:10]
- A. *...there may be one trust account where I believe there is money transferred but I don't have the exact information.* [63:12-63:14]

**13.3 Review of material by KPMG**

A review of the CLIENT 47 Trust nominal ledger held on the UNITY system suggests that bonds and units in a variety of Funds (including a small number of property based funds) were encashed and an amount of €3,375,255.23 was passed through the 'Stockbroker Capital account' and then transferred to ARF's current account. [KPMG Exhibit 18] Three amounts of €2,230,000 (27 May 2011); €325,820 (15 June); €820,435.23 (21 June) were then transferred from this account. These amounts were paid into a newly opened ARF Savings account held with

Bank of Ireland ['BoI'] and it was from this account that payments were then made to a range of property companies in Europe.

An exchange of emails dated 30 and 16 May 2011 between Harry Cassidy, Paul Lavery and Daniel Sommers refer to payments of €2,081,621.35 and €853,406.18 to two specific SPV property companies – Schleswig Retail SA and Jutland Retail SA respectively. The emails also state *'Paul, this is to be transferred from trust account and reflected accordingly'*. [Inspectors Exhibit 21] An exchange of urgent emails dated 1st June, again between Harry Cassidy, Paul Lavery and Daniel Sommers, discusses the need to immediately make a further payment of €137,783.45 in favour of Jutland Retail SA as the local authorities had *'issued an enforcement notice against the company's bank accounts' with the result that they could not 'pay the interest for Valois or any other invoices'*. Mr Cassidy instructed Mr Lavery to make the payment from ARF [Inspectors Exhibit 22].

Similarly the stock and bond holdings of the CLIENT 48 Trust were encashed. This is confirmed in email from David Wilson, Merrion Capital, to John Whyte dated 28 April, 2011 which states that the CLIENT 48 Trust account now only contained cash and that Merrion were awaiting an email instruction from CHC to transfer this money out. [Inspectors Exhibit 23] Subsequently an amount of €1,533,025.82 was transferred on 25 May 2011 to ARF's Bank of Ireland deposit account.

In aggregate this suggests that approximately €4.9 million of equity and bond assets representing virtually the entire holdings of the two trusts were encashed, transferred to bank accounts opened in BoI Baggot Street branch. Much of this money was transferred to and used to meet the liabilities of various property related developments promoted by CHC.



## **PART C: OTHER MATTERS OF CONCERN**

### **14. STAFFING ISSUES**

#### **14.1 Introduction**

The Inspectors have serious concerns about the current staffing arrangements at CHC. Due to the current precarious state of its finances it is uncertain whether future salary payments can be made to staff. Given the poor level of documentary evidence to validate or verify certain transactions much relevant information may not be available except through staff members' recollections of events. CHC have a deficit of experienced qualified staff at a senior level.

As of 31 March 2011, CHC had 23 staff members but in recent weeks a number of key staff have resigned. In recent months it has proven increasingly difficult for CHC to retain quality staff at a senior level due to the on-going issues. CHC's compliance function, which is a critical role within a regulated entity, has seen a high turnover rate due to short term contracts being available. The most recent Compliance Officer resigned from the position in early August 2011 and was not replaced. It should be noted that 9 members of staff who transferred to Appian as part of the proposed transfer of certain business were subsequently made redundant by Appian. The staff that transferred were made up of individuals who filled roles within various functions such as Client Servicing and Administration. The Inspectors are mindful of the fact that information possessed by certain members of staff is essential to the continued operation of CHC notwithstanding the fact that they may have been involved, at different levels, in the issues described in this report.

Following the appointment of Inspectors to CHC on 15 July 2011, CHC arranged with Horwath Bastow Charleton (HBC) for it to provide administrative support to CHC over the last number of weeks under the terms of a service level agreement. Without this support CHC would find it difficult to continue operating. Effectively HBC are endeavouring on behalf of CHC to ascertain the extent of the misappropriation of funds, and to liaise with the lending banks to see what effect if any a change in the investment manager in respect of the property SPVs would have on the various loan facilities. It is apparent that CHC does not have enough qualified or experienced staff to independently assess or complete a full reconciliation of all client holdings.

#### **14.2 Sworn testimony to Inspectors**

The following statements, including questions where relevant, are taken from sworn testimony given to the Inspectors:

**Mr Harry Cassidy on 19 July 2011**

- Q. Could there be something now that the staff could be doing that you could be... [68:22-68:23]
- A. *No, no, no, if I can make a statement on behalf of the staff, they are really good. Now, some of them might be a bit naive and may have had false loyalty and may have allowed things to happen that normally they might not, but things happen. None of the staff below management level, senior management level, can be blamed for any of this because they weren't asked to do things that they shouldn't do. A lot of the staff was above them and, therefore, didn't really concern them and they were getting on with doing their jobs and I wouldn't like to think that any of them would be held to account because they shouldn't be.* [68:24-69:06]
- Q. Of the senior management, who were aware? [69:07]
- A. *Well, of the senior management, obviously me as the most senior person.* [69:08-69:09]
- Q. Yes? [69:10]
- A. *John Whyte, as the next most senior person, and Paul Lavery would be the three people. We have had a myriad of changes of other people, so I couldn't...* [69:11-69:14]
- Q. John Mulholland? [69:15]
- A. *Well, you see, John Mulholland isn't part of CHC.* [69:16]
- Q. But of the problem... [69:17]
- A. *He's a director, but without executive responsibilities and he runs a separate company and, hand on heart, John wouldn't be aware of the extent of these issues.* [69:18- 69:20]
- Q. But he is aware there was issues? [69:21]
- A. *He might have had suspicions, but I genuinely never discussed them with him.* [69:22-23].

**Mr Neil Bowes on 26 July 2011**

When Mr Bowes was asked about delays in processing client requests he said "you just had to do the best you could."

- Q. And when that was raised at the senior staff meetings or at the board level was that, was any comment made? [52:04-52:05]
- A. *No. You know you're, without putting too fine a point, you are a brave person who puts up issues at a Board meeting with Harry running the show.* [52:06-52:08]
- ...
- A. *Unless you are absolutely sure of your ground it is probably more than your...* [52:10-52:11]
- Q. Right. [52:12]
- A. *You know you don't want to put your head above the parapet.* [52:13-52:14]

- Q. Were people afraid of Harry? [52:15]
- A. *Yeah, yeah. Hands up there are times when I wish I'd been more...* [52:16-52:17]
- Q. Yeah. [52:18]
- A. *But not an easy person to work with. This is not about telling tales, it is just simply the fact of life.* [52:19-52:20]
- Q. Yeah. [52:21]
- A. *Not an easy person. He ruled with an iron fist.* [52:22].

**Mr Paul Lavery on 19 July 2011**

- A. *That's one thing, you know, there was never enough time in any day. I suppose we were, just under-resourced, it was just a nightmare just keeping it going. Just haven't time to think, you know, it's just very, very tough work.* [4:13-4:17]<sup>52</sup>

**14.3 Conclusions**

In the view of the Inspectors, junior staff were not encouraged to raise queries as to the nature of instructions they were required to implement or process for clients and the style of management within CHC was not conducive to proper conduct of business.

The Inspectors are of the view that current staffing arrangements at CHC are not sufficient in order for it to continue operating. As mentioned above it is only because of the administrative support of HBC that CHC is able to currently continue to operate on a day to day basis. In order for clients' positions to be accurately validated there will need to be adequate resources to reconcile all holdings. The Inspectors have been advised that this process could take up to six months to complete, so therefore during that period, in whatever form this takes, the availability of qualified persons to conduct such an exercise will be critical.

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<sup>52</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

## **15. PROPERTY SPECIAL PURPOSE VEHICLES (SPVs)**

### **15.1 Introduction**

Concerns arise regarding the SPV structures that CHC used to invest in European properties, primarily located in France and Germany. Based on the most recent information available there are 43 German properties, five French properties and a further two properties which are located in Switzerland that are held in SPV structures. It should be noted that as mentioned in the section on Destiny Pooled Bank Accounts (B4) there are 18 syndicated property structures located primarily in the U.K and over 200 individual property investments held within the Destiny structure. With regard to the European properties, the SPV structures appear to be domiciled in Luxembourg, Denmark or Germany.

Such concerns would exist altogether apart from issues described elsewhere in this report arising on the misappropriation of funds that have been transferred to or applied for the benefit of SPVs, and the rights of clients, whose funds were so taken, in relation to those SPVs. There is a clear and worrying lack of visibility in relation to the operation of these SPV structures. Very little of the documentation relating to the operation and constitutional arrangements of the SPVs is located in CHC's office in Dublin. Similarly there appears to be a paucity of documentation related to the various associated loan agreements and property transactions. Mr Harry Cassidy was often solely involved in the purchase and sale of properties.

The audited financial statements of CHC for the year ended 31 March 2010 list 25 companies incorporated in Luxembourg (20) and in Denmark (5) to which the company provided property asset management services, and of each of which Mr. Cassidy and Mr. John Mulholland were directors at that time. Disclosure of earning of fees from these companies by CHC was required by the fact of the companies having common directors. The SPVs are not subsidiaries of CHC. They are separate legal entities but were in effect administered by CHC.

Amounts earned in all cases did not include fees earned for such services as rendered by CH Asset Management GmbH, a company established in Germany which provides property management services to a large number of the SPVs .

The notes to the financial statements, and the auditor's report, referred to the cash inflows of CHC being significantly reliant on the recoverability of debtor balances from property related entities. As at the balance sheet date an amount in excess of €2.6 million was owed to CHC by these companies.

The Central Bank was informed in October 2010 that the registration of certain client investments in the SPVs was not complete as the shares were held in the name of CHC and not the client. CHC executed Declarations of Trust to resolve this issue on an interim basis while the correct registration was completed. The Declarations of Trust stated that CHC were holding the shares in trust and acknowledging that the underlying client was the beneficial owner.

Each client's investment in an SPV would typically consist of a combination of interest free loan notes and share certificates, which should be available to the client. CHC submitted a letter on 1 July 2011 stating that there were seven SPVs where client securities were still registered in the name of CHC. The former Chief Executive Officer and Director of CHC was a director of CH Asset Management GmbH until 8 September 2011. Inspectors have also become aware of an enforcement order against Jutland Retail SA as it failed to pay Land Transfer Tax ("LTT").

A property known as Jardin D'Osaka was sold approximately 18 months ago. Currently no documentary evidence of the application of the proceeds of the sale is available within CHC.

Destiny Unit Trust 140 (Los Collados) refers to a property development which is located in Spain. Mr Sean O'Dwyer, chairman of CHC, has explained that Destiny 140 represents two properties which are held in two Spanish SPV structures. M & F Finance (Ireland) Limited ("M&F") act as the Trustees to the Destiny Exempt Unit Trust, the structure through which clients can invest into property via their pension. While M&F is the legal owner of all assets contained within these funds, the individual clients are the beneficial owners. The two properties assigned to Destiny 140 are an uncompleted commercial development and an Aparthotel (Hotel with apartments). The Inspectors were not able to establish that the appropriate documentation establishing the Destiny 140 Fund under the Destiny structure has been properly put in place.

## **15.2 Sworn Testimony to Inspectors**

The following statements, including questions where relevant, are taken from the testimony given to the Inspectors relating to the SPVs:

### **Mr Harry Cassidy on 19 July 2011**

Q. Just to back up there, I am still confused. Of the two cash funds, the PRSA cash fund and the simple cash fund, they were not actually in cash? [20:21-20:24]

A. *Well, originally they were, yes.* [20:25]

Q. But, now, they are... [20:26]

A. *They are not now, they are holding equity in the SPVs.* [20:27]

**Mr. Harry Cassidy on 2 September 2011**

Q. Could you describe to us how the Los Collados development is structured? It's quite confusing. [33:18-33:19]

A. *I will try, it's complicated. There are two parts to it in one portfolio. There is the aparthotel development which is called Los Collados Apartments and there is a commercial centre which hasn't been named yet because it hasn't been finished. The aparthotel development is completed and was completed over two years ago and is currently renting and receiving some income but not at the level that we would like and as a result we are in arrears with the Bank in terms of the loan and the commercial centre, the idea there was to build it and during the building phase obtain some pre-lets. with the downturn and severe downturn in the Spanish economy those pre-lets disappeared, so, therefore, we were left with a structure that we could either proceed with no pre-lets and, therefore, no bank likely to come in and fund it or, as we have proposed, is that we would, therefore, stop building as to where we are at the level now and mothball it until such time as the economy improved, which is where we are today. But they are both held in the Destiny Fund 1, four zero. The reason why it was held in Destiny is that on advice from KPMG who were the tax advisors in this particular structure, both in Dublin and through their Madrid office, it was felt appropriate that the unit trust would be a better way of holding it so that is M&F as trustees set up Destiny Fund 140 and then there is a separate company established for the holding of the Los Collados apartments and a separate company for the holding of the asset which would be the commercial centre.* [33:20-34:20]

Q. Right so who are the owners of the SPVs then? [34:21]

A. *Well the owners ultimately will be the investors in under Spanish law, the company has to be controlled by an individual. up until very recently that that would be controlled through our legal advisors, but about three months ago, possibly four months ago, mostly to do with the threats that were coming from the developer, the legal advisor, the advisor said he no longer wanted to be the name rep, what they call in Spain the administrator. So they transferred that into my name as the only person willing to do it so we went in front of a notary in Spain and I hold that certificate on behalf of the investors.* [34:22-35:05]

Q. And this is the certificate as the administrator for both? [35:06-35:07]

A. Yes. [35:08]

Q. Right. And who was the -- who was on that before you then? [35:09-35:10]

A. *The legal advisors.* [35:11]

Q. Is that a Mr. McGrath? [35:12]

A. *Tom McGrath, yes.* [35:13]

A. *And the reason why we used Tom, well, apart from that he was involved at the very beginning is also he has fluent Spanish and it is a difficult language and difficult to negotiate if you don't have the language. So he has an associate based in Valencia, Elizabeth and so any time we have any meeting or transactions she is always present.* [35:14-35:20]

- Q. Right. But is there any equity whatsoever in the commercial centre in SPV, is there any investor equity in it, as such? [35:21-35:23]
- A. *Well, there is -- in the aparthotel, the total transaction in the aparthotel was circa 13.5 million of which there is about 8.5 million of debt through La Caixa Bank -- sorry, caja Murcia Bank, C-A-J-AM-U-R-C-I-A. The company accounts are held in La Caixa Bank, C-A-I-X-A. SO that is the split and debt and equity on the aparthotel. There is no debt on the commercial centre, we hold the title to the site and the rest of the cash in is equity. So there is, anything else that is being used to pay the developer on to the building which, I think amounts to about 8.5million of the purchase site would all be cash. [35:24-36:06]*
- Q. Right, when you say equity, Harry, I understood that the monies invested in the absence of the bank the loan came from, came unknowingly from the investors? [36:07-36:09]
- A. *Well, that is what I am referring to as equity as cash that is not debt. [36:10-36:11]*
- Q. Right. [36:12]
- A. *So I am saying that anything that wasn't put in as debt on loan from anybody is equity or cash. [36:13-36:14]*
- Q. Right. Okay [36:15]
- A. *Who it's -- who owns that equity is a separate matter, but I am just referring to it as, in any property transaction you have debt and you have equity. In most cases, we have no debt on that particular property transaction, it's all cash. [36:16-36:20]*
- Q. And how much has gone into that, on the commercial? [36:21-36:22]
- A. *I think it's about, close to 9 million which includes the purchase of the site and the development to date which is at about 55% completed. so there is about another 3.5 million required, well, depends on what prices you use, 3.5 million thereabouts would be needed to complete it and hence our problem we couldn't get a bank to fund it, we didn't have any more equity, so the idea to mothball it until such time that matters improvement. [36:23-37:02]*
- Q. And is there a valuation on that centre? [37:03]
- A. *There wouldn't be a valuation, George, because you wouldn't know what that valuation would reflect. It's hard to get a valuation on an incomplete building. Anything you would be putting on valuation would just be guesstimates and they could be quite wild, you know, could be anything from 3 million to 8 million, you know, depends who you talk to. [37:04-37:10]*
- Q. Right. [37:11]
- A. *But very -- I think about 18 months ago, two years ago, when we were beginning to look at issues we didn't, at that time, own the site and we insisted if we were going to go forward with the developer that the site would be transferred to us. [37:12-37:16]*
- Q. Right. [37:17]
- A. *That is one of the reasons why he is getting very stroppy and threatening legal action because he thinks we pulled the wool over his eyes, but it was done with his agreement that he would transfer the site to us so that we would actually own the site. And we got a, at the time, a*

*discount as well on the final price, so we had a very tough negotiations but beneficial from the investors' point of view. [37:18-37:25]*

#### **Further on in the evidence of Mr. Harry Cassidy**

- Q. Yeah. I suppose I am struggling to understand if people were put into, let's just take the Los Collados commercial centre became a success and it repaid its people who had the money transferred in or indeed was sold and there was an excess of cash, where would that cash go? [38:08-38:13]
- A. *The excess of cash would have gone to the people who put the money in. [38:14-38:15]*
- Q. Even though they didn't know they were there? [38:16]
- A. *Well, yes. But I mean, I mean there was no where else for it to go. [38:17-38:17]*
- Q. It could have gone to CHC [38:19]
- A. *No, that wouldn't have been the intention. That is only speculation, that wasn't the situation that wasn't certainly the plan. [38:20-38:22]*
- Q. Right. [38:23]
- Q. How would you have explained to an investor who would have had an investment that there was going to be a return on that investment if they didn't know there was an investment in the first place? [38:24-38:28]
- A. *Well, that is an interesting question. [38:29]*

#### **Mr Paul Lavery on 19 July 2011**

- Q. If banks were looking for pledging of assets, for example, would you have any [29:18-29:19]
- A. *I'd have no dealing -- all the dealings with the SPV's essentially are done by Harry himself. He'd go meeting banks directly. I would have no involvement whatsoever. There was a lady before that who used to work in full-time, Deirdre Canavan. She worked on the property and then, after she left then, it was mainly Harry dealing with the investments and then, to a certain extent, Finn O'Connell would have took over some of the aspects of her role. [29:20-29:28]*
- Q. Right? [29:29]
- A. *Under his role, sorry, in the company. [30:01]*
- Q. In terms of payments that would have, say, come through the Client Asset accounts to SPVs, how would those instructions have been processed? [30:05]
- A. *Sorry? [30:06]*
- Q. In terms of payments that would have gone through Client Asset accounts and then into, say, the European property, SPVs, how would those transactions have come about? Who would have instructed the payment to be made and who would have processed it? [30:07-30:11]



A. *The instruction would have come from Harry. He would say 'Listen, there is money to go to a specific property' and he would say 'These are the clients that this payment should be allocated to'. Then he would come back and he'd approve the payments and that payment would be processed on Banking on Line, if it was Banking on Line, or through the bank. [30:12-30:18]*

Q. So would you process that? [30:19]

A. *I would set the payment up and usually somebody<sup>53</sup>else would authorise it, John Whyte or whoever was there would authorise the payment on his instruction. [30:20-30:22]*

Q. Then the approval would come from John or Harry... [30:23-30:24]

A. *Approval would only come from Harry directly. John would only approve on Banking on Line as he is the other party. You need, sorry, two approvals. So, you know, there is no investment initiated by anybody in there only Harry in relation to property-- like, nobody had any investments only him. [30:25-31:01]*

#### **Mr John Whyte on 25 July 2011**

A. *Obviously I have no control over the SPVs George. They are controlled directly by Harry and by Daniel Sommer, who runs, he is Managing Director of CH Asset Management. I am not privy to all of the bank accounts in those SPVs or I have no control over them. [76:04-76:08]*

Q. Have you ever seen the, have you ever seen the bank accounts or had access to them? [76:09-76:10]

A. *The only thing, the only thing I have reviewed, and Noel will be aware of this, is the SPV audit accounts, in terms of the sign off on the audit accounts and review them, but I haven't actually seen the bank account details or anything like that. [76:11-76:15]*

...

A. *The SPVs are controlled by Harry, Daniel, I think there is a third party signatory on that as well, but I haven't actually seen the physical bank accounts. [76:17-76:19]*

...

A. *But again going back to the reason why this is all started like in terms of the money trails, like I am absolutely sure that the monies have gone in through the SPV structure and there is a money trail for everything. [76:21-76:25]*

Q. Yes. [76:26]

A. *But the question is I don't know which SPVs they have gone into. [76:27]*

#### **Ms Leslie Coulter on 26 July 2011**

Q. Leslie I have no further questions but maybe if I ended up asking the same as I started out now that we have come through this process are there things that are still bothering you? [45:22-45:26]

A. *Yes, there is actually one thing that has come to light. Jardin d'Osaka. [45:27-45:28]]*

---

<sup>53</sup> Text has been deleted and underlined text has been added to the verbatim transcript by the interviewee

...

A. *D'O-S-A-K-A, has been sold without anybody's knowledge.* [46:03]

Q. Do you know what happened the proceeds? [46:04-46:05]

A. *(Shakes head no).* [46:06]

Q. Is Maurice aware of this? [46:07]

A. *He is now, yes.* [46:08]

...

Q. When did the transaction take place? [46:11]

A. *I can't pin down because our immediate, our immediate, both mine and Maurice was well how, why was that not escalated to the Property Committee? We are aware that it was before the Property Committee but it wasn't brought to the Board. I have checked the Board Minutes even before my time and it has not been brought to the Board.* [46:12-46:18]

Q. So that sale has taken place in the last year but you don't know where? [46:19-46:20]

A. *But again I can't pin down...* [46:21]

...

A. *And I don't know where. Now it may have gone to, I will throw it out there, Allemanic but, I mean that would be a starting point to look but again I wouldn't, I don't know.* [46:23-46:26]

Q. So it is unclear if the proceeds went back to the investors in that particular property? [46:27-46:29]

A. *I would probably say not. I know it is gone to a property, I just don't know which one but I would, I would start at Allemanic.* [46:03]

Q. What leads you to believe that it went to another property Leslie? [46:04-46:05]

A. *Discussion with John Mulholland. Because the way that came to our attention was Harry stopped John Mulholland in the corridor and said "oh by the way I sold Jardin d'Osaka and the money is now in another property". Now when I pushed John Mulholland on it he didn't, he didn't, didn't know what property it was or anything but Maurice then pushed Harry on it and Allemanic was mentioned.* [46:06-46:13]

#### **Mr John Mulholland on 25 July 2011**

Q. Right. What about the relationship with Custom House Capital Asset Management Germany? [40:06-40:07]

A. *Yes, that came up for discussion this morning. Custom House, this is something which Harry Cassidy set up about two years ago and what he, what he was, what he had previously done in, in as much as I can, I mean I will tell you as much as I know about it.* [40:08-40:12]

...

A. He set up a company to manage the properties and take the management, the day-to-day management, the facilities management, for want of a better word, away from another firm. The person who would have headed that up used to work in Merrion Square, Daniel Sommer, and they would have been back here about six months ago. [40:14-40:20]

...

A. And the way it is structured, and sorry I was only discussing it this morning, the way it is structured is, as I understand it, Brian Conroy had a different understanding of it, but that company so it collects, it collects management fees and transports them back to Ireland, as I understand it, and also looks after the day-to-day facilities management of the properties. It was described to me by Harry as a company which, in which he holds 51% of the shares and he says that he was holding some of those for me. There is no piece of paper about that or just, you know – [40:22-41:03]

Q. Of the 51%? [41: 04]

A. Of the 51%. [41:05]

### 15.3 Forensic Examination by KPMG

#### Destiny Property 140 (Los Collados)

Below is a summary of the payments allocated as loans to Los Collados:

#### Loans to Los Collados

		€	€	€	
Fund	Account				Comment
Destiny Select II Cash	Debtors				Email indicates an amount to cover a repayment to a client
			339,877		
Destiny PRSA Equity	Bonds	906,874			Payment of €523,970 to Spanish accounts, remainder to other CHC Bank accounts
	Debtors	744,100	1,650,975		Email indicates an amount to cover a repayment to client
Destiny Equity	Bonds	557,387			All transferred to La Caixa
	Debtors	286,047	843,435		Payment of €250,000 to La Caixa, €36,047 to Hauck &Aufhauser
Destiny PRSA Cash	Cash savings			3,345,765	All transferred to Spanish Bank account, Caja de Alhorros de Murcia
		TOTAL	6,180,052		

It appears that €4,677,122 was transferred to Spanish accounts and may therefore relate to Los Collados, but of the remaining €1,509,930:

- An amount of €339,877 appears to relate to a repayment to CLIENT 7, taken from the Destiny Cash Select II cash account, but accounted for as a loan to Los Collados. See e-mail 16 February 2011 between Paul Lavery, Harry Cassidy and John Whyte. [KPMG Exhibit 37]
- An amount of €744,100 appears to relate to a repayment to CLIENT 21, taken from this account, but accounted for as a loan to Los Collados; CLIENT 21 was sent a valuation report as at 29 October 2010 showing an investment of €735,000 in Destiny 140/Los Collados, instead of cash. E-mail 27 February 2011 from Harry Cassidy to Paul Lavery stating “Paul problem here. how did this go out if its incorrect and how is he in los collados...” There was insufficient cash to repay investment, and repayment was made from Destiny PRSA Equity Fund account. [KPMG Exhibit 77]
- Hauck &Aufhauser, a German bank (see section B6) received €36,047.
- Payments from Destiny PRSA Equity of €382,904, which includes the payment of funds to an investor on the sale of a different property of €305,053. [KPMG Exhibit 72]

It is therefore questionable whether these funds were indeed all related to the Los Collados development. They are recorded as debts owed by Los Collados when it actually appears that they have been used to meet client requests for redemptions.

The Investment Cross Holding report for this unit trust does not include any of the four funds above as investors. Copies of the undated application forms for the above funds, signed by Harry Cassidy on behalf of each fund, are shown in [KPMG Exhibit 79].

#### **15.4 Conclusions**

The Inspectors are of the view that certain money has been recorded in Destiny 140 (Los Collados) as ultimately owing by it, whereas some of such funds had, in fact, been used to discharge expenses and payments to other clients.

Therefore more generally any review of an SPV to ascertain how much money may have been diverted inappropriately will need to consider that while some money may have gone into it, some may have been used to pay redemption requests for unconnected investors but still be recorded as a debt of the SPV.

## 16. PROFESSIONAL INDEMNITY INSURANCE/MEZZANINE BOND INSURANCE

### 16.1 Introduction

It has been brought to the attention of the Inspectors by the Chairman of CHC that the Professional Indemnity Insurance premium for 2011/12 for CHC has not been paid. Mr O'Dwyer told the Inspectors that he had received a representation from Mr Cassidy, the former Chief Executive Officer of CHC, that it had been paid but this turned out to be inaccurate. The policy was due for renewal on 12 July 2011 and although it was not renewed at this time CHC remained on cover until 26 July 2011. CHC have been unable to source alternative cover. CHC has informed the Inspectors that they intend to engage a firm of solicitors specialising in Professional Indemnity Insurance in order to ascertain whether potential claims arising are covered by the policy that was in place up to 26 July 2011.

In April 2010, following concerns expressed by the Central Bank, CHC sourced an insurance policy to cover potential claims arising from a shortfall in respect of the Mezzanine Bond. This eventuality would only arise where CHC was determined to have an inability to pay claims. CHC secured cover in May 2010 for the bond for a 12 month period to be renewed on a yearly basis. CHC informed the Central Bank in May of this year that the policy was being renewed for another year. However the Central Bank was subsequently informed by Mr O'Dwyer that only 50% of the premium of the Mezzanine Policy had been paid with the remaining 50% due to be paid in August. CHC have submitted cashflows for the period August to October 2011 and included in these figures is provision for the payment of the remaining 50% Mezzanine Bond policy premium. As of 17 October 2011, CHC have represented to the Inspectors that the balance of this premium has now been paid.

#### Sworn testimony

Ms Leslie Coulter gave the following sworn evidence in this regard.

#### Ms Leslie Coulter on 26 July 2011

Q. When is that due to be paid? [38:07-38:08]

A. *The, the Mezzanine bond?* [38:09]

Q. Yeah, the insurance? [38:10]

A. *It was due to be paid four weeks ago, June, and I was told it was paid.* [38:11 – 38:12]

Q. By who? [38:13]

A. *Harry, and it was actually the insurance broker who phoned me and said we haven't got it paid yet. I was like oh no it is, and then I was like I will go and check and when I checked it was em –* [38:14-38:17]

Q. So there is no cover then if it is not? [38:18-38:19]

A. *It is on cover but it is not paid.* [38:20]

...

A. *So how long that stays like that I don't know.* [38:22]

Q. Have the brokers said that they will only keep cover for a certain period of time? [38:23-38:24]

A. *No, they are more concerned that because the Mezz hasn't been paid and they are trying to broke for the PII, well it doesn't look very good obviously. So that came up again today so we are, we are, I think Sean has authorised the payment of the Mezz today to get, to get it done anyway and then, well we are not hopeful about PII anyway.* [38:26-38:03]

## **17. LUXEMBOURG ACCOUNT IN JOINT NAMES OF MR CASSIDY AND MR MULHOLLAND**

### **17.1 Introduction**

In the course of researching the operation of the 'Stockbroker Capital Account' at the request of the Inspectors, an email referring to an account held jointly in the name of H Cassidy and J Mulholland held in Fortis Banque, Luxembourg ("HC/JM account") was identified by KPMG. [KPMG Exhibit 17]. The Inspectors requested KPMG to conduct a search for any other payments which may have been made to that account.

### **17.2 Forensic Examination**

The correspondence which initially identified transfers to the HC/JM account consisted of an email dated 24 August 2009 from Paul Lavery to Michelle Donnelly and cc'd to Harry Cassidy confirming that a payment in the amount of €25,000 had been set up on the Client Gross Savings Account for payment to an account in the name of 'H Cassidy/J Mulholland'. The email requested Michelle Donnelly to approve the transaction. The reference quoted in the email as a description of the payment was 'commissions payable to John and Harry.' [KPMG Exhibit 17].

Further investigation revealed that at least 12 payments were made from one or more pooled client accounts either directly to the HC/JM account or indirectly through another Fortis Banque account held in the name of the Maximillian Centre or Schleswig Retail. These payments were made over a period from 18 December 2007 to 24 December 2009. Those payments which contained a reference stated that the payments related to commission. The information was found on Mr Paul Lavery's home drive, and not on the shared server, in a folder referred to as 'Accounts/Invoices/HCJDM'.

The aggregate value of the transfers, which have been identified, into the HC/JM account from CHC client accounts is €2,317,030 while the value of payments out of that account which have been identified amount to €2,415,000. A payment of €100,000 was made out of the account in January 2009 for which the corresponding receipt has not been identified.

The investigation further revealed that all save one of the payments into the HC/JM account were almost immediately paid out from that account to a bank account in the Isle of Man held in the name of John Caldwell. Payment instructions on a payment dated 24 June 2008 requesting a transfer of €500,000 to John Caldwell stated that:

*'This represents a payment being made for the buyback of shares in respect of a company (The European Pensioner Trustee Company Limited). Shares are currently held by the above beneficiary to whom payment is being made. This payment is the third of four instalments which will be made over the next eighteen months.'*

A version of the above reference appeared on a number of the invoices and payment instructions addressed to Fortis Banque relating to transfers to John Caldwell. The total value of identified payments made from the HC/JM account to the account of Mr Caldwell amounted to €2 million.

A further payment of €415,000 was made in July 2008 from the HC/JM account to Fred Olsen SA, Tenerife. The related instruction to Fortis Banque [KPMG Exhibit 99] dated 4 July 2008 records this as a payment to Fred Olsen SA, Santa Cruz, Tenerife for completion on the purchase of a property.

€1.75 million in aggregate of payments to the HC/JM account were made on foot of five invoices, each dated between 18 December 2007 and 11 February 2009 [KPMG Exhibit 97], all addressed to Maximillian Centre, 20 Rue de la Poste, L2346 Luxembourg. The description on each was "Commission due in respect of marketing and placement fee for property known as Maximillian Centre." Payment was requested to be made to a Fortis Banque Account, in the name of "Mulholland and Cassidy," account number XXXXXX. Eight faxes dated between 7 July 2008 and 12 November 2009, all addressed to Fortis Banque, were sent from Paul Lavery on CHC stationery. Each one says:

*"Please find attached signed instructions on behalf of Harry Cassidy/John Mulholland for Account IBAN number XXXXXXXXXXXXXXXXXXXX."*

In the hard drive there were 12 letters to Fortis Banque, all with spaces for signature by Harry Cassidy and John Mulholland, and all requesting transfers from the Mulholland and Cassidy Account, IBAN number XXXXXXXXXXXXXXXXXXXX. The majority of these transfers, 11 totalling €2 million, were made to a Barclays Bank Premier Account in the Isle of Man in the name of Mr Caldwell. One payment, €415,000, was made to Fred Olsen SA to a bank account in the Canary Islands.

The email accounts of Harry Cassidy and Paul Lavery contain certain further information relating to these payments. In respect of 11 of the 12 payments identified above, an email from Paul Lavery to Harry Cassidy and John Whyte requested authorisation for a transfer from a CHC pooled account to a Fortis Banque Luxembourg account. [KPMG Exhibit 100]



- For the first three payments, Paul Lavery requests authorisation to transfer funds from the CHC pooled accounts to the Fortis Banque account of Maximillian Centre, then he requests Fortis Banque to transfer funds from that bank account to the Fortis Banque account of Cassidy and Mulholland. [KPMG Exhibit 101]
- For the fourth payment, Paul Lavery requests authorisation to transfer funds from the CHC pooled accounts to the Fortis Banque account of Schleswig Retail, then he requests Fortis Banque to transfer funds from that bank account to the Fortis Banque account of Cassidy and Mulholland. [KPMG Exhibit 102]
- For the remaining payments (with the exception of the sixth for which no emails have been identified to date), Paul Lavery requests authorisation to transfer funds from the CHC pooled accounts to the Fortis Banque account of Cassidy and Mulholland.

In an email dated 17 December 2007, Harry Cassidy stated to Paul Lavery:

*"Paul I will advise you tomorrow why but it is critical the monies hit correct accounts tomorrow.*

*Step 1 450k to luxco*

*Step 2 450k to lux acct hc/jdm (will you need instruction? If so do an invoice etc)*

*Step 3 transfer only 400k (four hundred only without charges) to an account in iom I think Barclays) jdm/ruth to give you account details. This is urgent please."* [KPMG Exhibit 103]

### **17.3 Sworn Testimony**

The following statements, including questions where relevant, are taken from the testimony of witnesses in this regard:

#### **Mr Paul Lavery on Friday 26 August 2011**

When asked whether he was aware of any other commissions that are being paid to officers of CHC he replied that the:

A. *...only commission that would have been paid to officers of CHC would have been commission was paid to Harry and John in respect of the QIF 1, the QIF 1 project. [10:15-10:18].*

When Mr Lavery was asked to explain on what basis the commissions would have been paid directly to Harry and John, as opposed to Custom House Capital, he responded that:

A. *All I was ever told was this was the commission due to them as they had given a personal guarantee on a loan to get this property in Marseille. [12:24-12:27].*

Mr Lavery stated that an

A. *...invoice would have been raised by John and Harry to the QIF and then that would have been paid directly to the Luxembourg account and then that would have been paid out wherever Harry would request. [12:11-12:14]*

He understood that the money would come

A. *...directly from wherever the cash was sitting on the QIF -- it was clients' savings, one of them accounts. [12:16-12:18]*

Mr Lavery confirmed that the

A. *...money was paid to Luxembourg and then it was taken on commission on behalf of Harry and John and then it was paid over to this John Codwell. [11:20-11:22]*

In relation to this payee, he stated that

A. *All I was ever told was he was a shareholder in EPT and this was a payment to buy him out of his shareholding of the company. [11:25-11:27]*

Mr Lavery stated that to his knowledge there were only ten to twelve transactions across the HC/JM account, both Mr Cassidy and Mr Mulholland *'would have signed instructions to transfer any monies out of that account'*. [14:26-14:27]

The following question was also put to Mr. Lavery:

Q. I am just wondering if commission was paid to this joint account which Harry obviously had an economic interest in, why was all the money then paid to this person in the Isle of Man, given that Harry had no shareholding or no interest in EPT? [14:14-14:19]

A. *That's what I don't know. It's probably because he was just -- him and John, I don't know what agreement they had in place behind that, to be honest with you. [14:20-14:22]*

#### **Mr John Mulholland on Friday 26 August 2011**

In testimony given on Friday 26 August Mr Mulholland was asked whether he had personally earned commissions from work carried out on behalf of CHC or in relation to properties in CHC. He responded:

A. *I would have -- well, not personally, but I would have, perhaps through European Pensioneer Trustee Company, received some commissions from Custom House Capital. [11:05-11:07]*

Q. Would that be in the normal course of introducing business? [11:08-11:09]

A. *It would be in the normal course of introducing business, yes. [11:10-11:11]*

When asked whether he had 'any direct involvement in dealing with the Maximilian Centre or the Karlsruhe fund?' [11:20-11:21], he responded:

A. *Other than raising money for investors to put money into it, that would be the only involvement that I would have. [11:22-11:24]*

When asked whether he was aware of the HC/JC account Mr Mulholland confirmed that the opening of that account '*..would have been done by Harry and I on a visit in Luxembourg.*' [17:04-17:05]. When asked what the payments into the account were in respect of he replied:

A. *I couldn't quantify it, but I believe that some commissions were paid to that account.* [12:10-12:11]

A. *I believe that they would be in respect of the securing of property of cash investments for investment in property.* [12:13-12:15]

Q. Is there any reason why they would go directly to Harry or yourself, as distinct from to CHC or back to EPT? [12:16-12:19]

A. *I can't identify any particular reason why they would be paid to the individuals, as opposed to CHC or EPT.* [12:20-12:21]

Further on in the evidence of Mr John Mulholland

Q. I suppose, I am at somewhat of a loss to understand why 2.5 million in relation to the QIF properties ended up in a Luxembourg account. It seems a lot of money in relation to the introduction of investors. I am not even sure how that works, John? [14:01-14:05]

A. *I can understand how you would find this difficult. But these were additional fees or commissions that would have been earned as a result of securing investments.* [14:06-14:09]

When Mr Mulholland was later again asked why the commissions were paid to individuals and not CHC he responded:

A. *Well, commissions would have been paid to EPT and/or --no, probably EPT. These were an additional commission which were secured.* [17:24-17:26]

Q. Additional in respect of what? [17:27]

A. *In respect of the sourcing of the -- which is what Harry was involved in -- the sourcing of the properties and securing the properties and the additional work that was involved for that.* [17:28-18:02]

When asked what the funds were used for Mr Mulholland replied:

A. *I am not just sure what the funds were used for and I am not sure if the funds remain in the account currently.* [13:03-13:04]

A. *So I can't say anything further in relation to what the funds would be used for.* [13:07-13:08]

However when advised that the records of CHC would suggest that the funds were applied to the purchase of shares in EPT (which may have been redeemed and cancelled), Mr Mulholland then replied:

A. *I believe that might be an accurate view of how some of that money was applied.* [13:19-13:20]

He was then asked whether he could recall the mechanism for the making of those particular payments and responded:

A. *Harry actually would have made the arrangements to transfer the cash at that time.* [15:27]

Q. And why would that have happened? My understanding is that Harry wasn't a director or a shareholder of EPT? [16:02-16:03]

A. *He wasn't, that is correct, yeah, but he would have been instrumental in arranging the payments.* [16:04-16:05]

A. *Because he more or less controlled the flow of the money at that time.* [16:07-16:08]

A. *Co-ordinating the transfer of cash and the transfer of monies.* [16:15-16:16]

Mr Mulholland stated that he and his wife, Ruth Woods, were the sole owners of EPT [22:01] and that the payments to John Caldwell were solely in relation to the purchase of shares [21:23]. He then went on to state, however, that the shares were purchased '*on behalf of both Harry and myself.*' [22:18]. When asked to clarify why Mr Cassidy would purchase shares in EPT only to have those shares redeemed Mr Mulholland asserted that the shares related to a '*..shareholding that John Caldwell would have had within Custom House Capital.*' [22:21-22:22]

The significance of this latter exchange only became clear to the Inspectors following the testimony of Mr Cassidy which is discussed below.

In relation to the single payment of €415,000 from the HC/JM account to Fred Olsen SA, Mr Mulholland confirmed that this related to a transfer '*..to Fred Olsen for the purchase of a property in my name.*' [18:09-18:10]

### **Mr Harry Cassidy on Friday 2 September 2011**

Mr Cassidy was requested to give testimony on a second occasion on 26 August but initially declined. Following an exchange of correspondence, Mr Cassidy agreed to provide testimony to the Inspectors on 2 September 2011. The following extracts refer to issues surrounding the HC/JM account.

Mr Cassidy was asked whether there were circumstances where payment of commissions in general to officers of CHC, including himself, could be made. Mr Cassidy's response was:

A. *Not to my knowledge and I would be involved in approving, you know, sanctioning anything like that.* [9:02]

Later Mr Cassidy confirmed that he was aware of the HC/JM account and described it follows:

A. *The account was set up in our joint names. John and John still is, I am a, what would you call it, non-domiciled for tax purposes because I hold a British passport and John is the same. One*

*of our intentions was over a period of time we might be in a position where we could get some fees paid to us legitimately from Europe. That was the intention of the account. [17:19 – 17:25]*

Q. Hmm. Right. And what was the basis for the payments into that account then? [17:26-17:27]

A. *I would have to check, but I think the idea was that we would receive fees that we could justify, if, on the basis of what transactions we might have done or, you know, what gains might have been made on properties. There was various ideas and nothing concrete that I can recall. [17:28-18:04]*

Mr Cassidy expressed surprise that payments may have come from clients' accounts as they should have been from CHC's fees and not from clients. While Mr Cassidy confirmed that he had knowledge of the amount of transfers he claimed that he did not receive the money. However when asked what the money was used for he replied:

A. *John Caldwell was a, inverted commas, a silent partner in CHC for a number of years since when we set it up. And around, back end of 2007, he approached us, or we approached him, I think it was a joint thing for him to get out. We weren't comfortable, I particularly wasn't comfortable with him because of the problems that he was having and what impact that might have on our reputation if that became evident that he was involved. And we wanted anyway to control the company ourselves, because, at that time, it was looking as if it had the opportunity to be significantly valuable, just as things were peaking in 2007. So, there was various meetings between him and John Mulholland and myself to discuss how we would get him out. Now, as I think you are probably aware, he is involved or was involved with John Mulholland in various companies that John would have, he is not a friend of mine, he is a contact of John's, I never knew him before I set up with CHC -knew of him, didn't trust<sup>54</sup> him and during the course of the early parts of the negotiations, I had a very significant row with him over what he believed was the value and what I believed was the value to the extent that he got up and walked out of the meeting and refused to negotiate with me any further and did all his negotiations with John Mulholland. [20:03-20:27]*

A. *And we agreed then that whatever we agreed the price of the thing, I think it was about 1.5 million was the figure that I recall for the CHC part. Any other payments were in relation to EPT and we agreed a schedule of payments over a 12-month period. [20:29-21:04]*

Mr Cassidy confirmed that subsequently cashflow difficulties caused this 12-month period to extend out. The Inspectors then noted that the review of the CRO data did not show the third party as a registered shareholder in CHC and Mr Cassidy clarified that:

A. *John Mulholland was holding the shares effectively in trust ... John Caldwell and John Mulholland would have exchanged declarations of trust to reflect that. [21:19-21:23]*

Mr Cassidy set out that when CHC was established the true ownership was divided up as follows:

15% Tony Burke and Patrick O'Sullivan,

5% John Whyte

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<sup>54</sup> Text has been deleted and underlined text has been amended from the verbatim transcript by the interviewee

20% John Caldwell,

20% John Mulholland,

20% Ruth Woods<sup>55</sup>; and

20% Harry Cassidy<sup>56</sup>

Mr Cassidy indicated that at a later date Mr Mulholland transferred a further 5% share in the business to John Caldwell. When this emerged Mr Cassidy indicated that it 'caused a significant divide in his relationship with Mr Mulholland. [22:25]

Mr Cassidy said that the agreement '*...with John Caldwell covered every involvement he had with John Mulholland.*' [23:16-23:17]

The Inspectors also queried whether CHC had paid any tax on the €2.5 million transfers. Mr Cassidy replied:

A. *Well, I presume they came from fees that would have been covered in our fee income. I would have to check [31:16-31:17]*

#### **17.4 Documentation provided by Mr Mulholland**

Following his testimony under Oath on 26 August 2011, the Inspectors wrote to Mr Mulholland on 29 August requesting the provision of material he had available in respect of the changes in the share capital of EPT. Specifically he was asked to provide all documentation relating to the consideration paid to Vincent Caldwell and Jennifer Caldwell regarding their redemption of shares in EPT and the payment arrangements. Mr Mulholland replied by letter dated 31 August stating:

*'In relation to the other material mentioned in your letter it is not available to be furnished, and although I am anxious to be of assistance I cannot make any comment on a voluntary basis in relation to this matter.'*

The Inspectors by letter dated 2 September 2011, which was scanned and emailed, repeated their request citing regulation 169(1)(b)(i) of the MiFID Regulations. Mr Mulholland responded the same day by email and provided a copy of signed agreement dated 15 December 2007 [Inspectors Exhibit 24] whereby the Seller (listed as Mr John Caldwell) as owner sold 95 ordinary shares in EPT to the Buyer (listed as Mr Mulholland) in return for a consideration of €500,000. However, in the same document Mr Vincent Caldwell is noted as the registered holder of the shares.

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<sup>55</sup> 28% in reality

<sup>56</sup> 12% in reality since 40% of this shareholding was in fact held on behalf of Ruth Woods

Mr Mulholland in his email requested 'further time to provide the information in relation to the balance of payments in consultation with the relevant parties.'

The Inspectors responded on 2 September by letter, scanned and emailed, again citing regulation 169(1)(b)(i), noting his request and requiring that outstanding material be provided by close of business on Monday 5 September. A further request was also made citing as follows:

*'During the course of the examination under oath, you outlined that Mr John Caldwell previously had a shareholding in Custom House Capital Limited and that he relinquished those shares in 2007. It has come to the attention of the Inspectors that the shareholding of Mr Caldwell in Custom House Capital Limited appears to have been held in trust on his behalf by you and that a trust document was established between you and Mr Caldwell relating to this specific arrangement. Can you please forward any and all documentation relating to shares held by you in trust for the third party in respect of Custom House Capital Limited. Please note that you are obliged to provide the inspectors with this documentation under Regulation 169(1)(b)(i) of the European Communities (Markets in Financial Instruments) Regulations 2007.'*

A deadline of close of business on Monday 5 September was also applied in respect of the additional request.

Following numerous attempts to contact Mr Mulholland, on 28 September 2011, following an earlier holding letter of 20 September, Sheehan & Partners solicitors, who had been newly appointed to represent Mr Mulholland, forwarded to the Inspectors copies of documents (originals and copies) in the possession of Mr Mulholland relevant to the arrangements made by him for any third party to have any interest in his shareholding in CHC. These documents [Inspectors Exhibit 25] disclosed:

- (a) that on 16 April 2001 it was agreed that Minerva Financial Services Limited, 53 Strand Street, Douglas, Isle of Man, would acquire 25% of the issued shares of CHC from Mr Mulholland, on the basis that these shares would be registered in his name, and would be transferred by him as and when requested to do so;

- (b) that on 23 January 2003 Mr Mulholland declared that he held 25% of the shares in CHC registered in his name as nominee and trustee for the Sentinel Private Pension Trust, Logan Street, Thomastown, Co Kilkenny; and
- (c) that on 15 December 2007 John Caldwell of Ballachrink House, Brac-a-Broom Lane, Glen Moar, Loop Road, St John's, Isle of Man, covenanted and agreed that in consideration of the payment of €1.5 million to him by Mr Mulholland he irrevocably acknowledged and confirmed that he would make no claim to have any right or interest in any ordinary shares issued by CHC and that he had not assigned or transferred or purported to assign or transfer any such right or interest. The amount of €1.5 million was to be payable to him in four instalments, namely €300,000 on 18 December 2007, €450,000 on 27 January 2008, €375,000 on 30 June 2008 and €375,000 on 14 December 2008.

## 17.5 Companies Registration Office

- (a) European Pensioneer Trustee Company Limited

The Annual Return filed for EPT to 5 September 2007 [KPMG Exhibit 104] showed that there were 300 ordinary shares held in the company. The shareholders were listed as John Mulholland with 95 shares, Ruth Woods with 95 shares, Vincent Caldwell with 95 shares and Jennifer Caldwell with 15 shares. Both John Mulholland and Ruth Woods were listed as the sole Directors while Ruth Woods also acted as Secretary.

The Annual Return filed for EPT to 12 November 2008 [Inspectors Exhibit 26] showed that there were now only 190 ordinary shares held in the company. The shareholders were listed as John Mulholland with 95 shares and Ruth Woods with 95 shares. It was noted that by ordinary resolution of the company at an EGM held on 18 December 2007 the ordinary shares held by Vincent Caldwell and Jennifer Caldwell were converted into redeemable ordinary shares [KPMG Exhibit 104] and that the Directors were authorised to redeem these shares on such terms as the Directors may determine and thereafter to cancel such shares. These shares would therefore appear



to have been redeemed and cancelled on 18 December 2007. Both John Mulholland and Ruth Woods remained as the sole Directors.

(b) Custom House Capital Limited

The Annual Return filed for Custom House Capital Limited to 26 October 2006 [Inspectors Exhibit 27] showed that there were 130,000 ordinary shares held in the company. These shares were made up of a combination of 19,500 A shares and 110,500 B shares. The shareholders were listed as Tony Burke with 9,750 A shares, Pat O'Sullivan with 9,750 A shares, Harry Cassidy with 52,000 B shares<sup>57</sup>, John Mulholland with 52,000 B shares and John Whyte with 6,500 B shares. The Directors were listed as Harry Cassidy, John Mulholland and John Whyte. The Annual Return filed for CHC to 26 October 2010 [Inspectors Exhibit 28] showed that John Anthony O'Dwyer was also a Director of the firm, he was appointed as a Non-Executive Director of CHC on 2 July 2009 [Inspectors Exhibit 29]. It was noted that by special resolution of the company dated 18 January 2010 8,775 A Ordinary shares held by Mr O'Sullivan and Mr Burke were transferred and re-designated as B Ordinary Shares to John Mulholland 3,575, Harry Cassidy 3,575 and John Whyte 1,625 [Inspectors Exhibit 30]. The remaining 10,725 of Mr O'Sullivan's and Mr Burke's Ordinary A shares were transferred to following individuals, Finn O'Connell with 1,625 Ordinary A shares, Neil Bowes with 1,625 Ordinary A shares, Sean Kenzie 1,625 Ordinary A shares, Ruth Woods 1,625 Ordinary A shares, Clodagh Benson 1,625 Ordinary A shares, Suzanna Cummins 1,300 Ordinary A shares and Paul Lavery 1,300 Ordinary A shares. On 18 May 2010 12,310 B shares were allotted to Harry Cassidy and John Mulholland equally bringing the total issued share capital of the firm to 142,310 divided into 10,725 A ordinary shares and 131,585 B ordinary shares. The Annual Return for 2011 has not been filed with the CRO and as such the change in shareholding is noted by a letter submitted to the Central Bank dated 19 January 2010. [Inspectors Exhibit 31]

The inspectors could not locate a record of Mr John Caldwell appearing as a shareholder of either European Pensioner Trustee Limited or Custom House Capital Limited.

## 17.6 Information as to shareholdings in CHC furnished by it to the Central Bank

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<sup>57</sup> In his testimony Mr Cassidy stated that 40% of his initial holding was held for Ms Ruth Woods. This means that of the 52,000 B shares, 20,800 B shares were actually held for Ms Woods and 31,200 B shares held for Mr Cassidy

As required by the Central Bank, CHC has furnished information annually to the Central Bank as to the identity of the persons holding shares in its capital, and certain of these annual notifications have confirmed that no other person had any indirect holding of shares. See Inspectors Exhibit 32 which contains such annual notifications between 2001 and 2007. The MiFID Regulations (and previously the Investment Intermediaries Act 1995) regulate the holding of a qualifying shareholding in an investment firm by any person.

## **17.7 Conclusions**

In the view of the Inspectors the funds amounting to €2,317,000 paid into the HC/JM account originated from various client cash accounts held in CHC and they did not come from the bank accounts of CHC itself.

The Inspectors are also satisfied that the purpose of the payments amounting to €2,000,000 from the Luxembourg account was the purchase of shares in EPT for a consideration of €500,000 and the purchase of shares in CHC for a consideration of €1,500,000, rather than the stated purpose on the bank transfers which referred solely to shares in EPT.

The Inspectors are of the view that there is a discrepancy between the information as to shareholdings in CHC, and the absence of any indirect holding, furnished by CHC to the Central Bank previously and the information on that subject furnished by Mr Cassidy and Mr Mulholland to the Inspectors.

## **18. M & F FINANCE (IRELAND) LIMITED**

### **18.1 Introduction**

M & F Finance (Ireland) Limited (“**M&F**”) is a private company limited by shares, with registration number 212297 in the Companies Registration Office (“**CRO**”) and having its registered office and principal place of business at 9 Merrion Square, Dublin 2 (the same address as CHC). The ownership of the share capital of M&F is as follows:

John Mulholland – 24,001 ordinary shares

Ruth Woods – 1 ordinary share

The European Pensioner Trustee Company Limited – 100 ordinary A shares

Until recently, the directors of M&F were Harry Cassidy, John Mulholland and Ruth Woods. On 9 September 2011 a Board meeting took place and three new directors joined the Board namely Brian Conroy, Andrew Whitty, and Albert Farrell with Harry Cassidy resigning from the Board. The abridged Balance Sheet of M&F as at 30 June 2010 shows shareholders’ funds of €97,831. M&F is not regulated by the Central Bank.

### **18.2 Business Activities**

M&F act as the trustees to the Destiny Exempt Unit Trust structure, an investment vehicle through which as outlined previously in this report clients can invest into property and other assets (i.e. cash / equities) via their pension. M&F is the legal owner of all assets contained within the unit trust structure with the individual clients being the beneficial owners. With regard to property investments, each property is held within a specific unit trust and a loan may be required to complete the purchase. Any finance secured is effected in the name of M&F, and all loans are non-recourse to both M&F and the client.

When a client invests by means of a Destiny property unit trust, the client will receive units in that trust at the time of their investment. Monies within each unit trust including rental income generated is used to cover loan repayments and other property expenses. However, in many cases additional contributions are required from clients to service payments in the case of rental shortfalls or unexpected expenses. The main cash inflows into unit trusts are rental income / client contributions and the main cash outflows are loan repayments / property expenses / bank interest. If payments are not met by each individual unit trust this could result in late payment penalties / breach of loan covenants / increased loan margins.

CHC acts as the investment manager to the Destiny Exempt Unit Trust structure. It is understood that there are over 200 non-syndicated properties and 18 syndicated properties currently held in various Destiny unit trusts. These properties are primarily located in Ireland and the UK.

### **18.3 Recent Issues**

The Governor & Company of the Bank of Ireland gave notice to M&F on 12 August 2011 of the appointment of fixed charge receivers to seven apartments located in Birmingham held in the Destiny 82 property unit trust. It is understood that the fixed charge receivers were appointed as an annual repayment of capital for each loan was not made.

### **18.4 Conclusion**

While M&F is a separate legal entity it has no operational staff of its own, and CHC had provided all necessary support systems and human resources.

## 19. NON-PROPERTY CLIENT ASSET HOLDINGS

### 19.1 Background

CHC manages on behalf of its clients (i) a large portfolio of property investments and (ii) various non-property investments held with a number of third party providers. The most recent information available to the Inspectors as at September 2011 indicates that there is approximately €87,300,000 in non-property client holdings held with third party providers. These investments are held in various asset classes such as transferable securities, unit funds, cash deposits and bonds. The table below sets out a summary of the non-property assets managed by CHC on behalf of clients.

<b>Third Party Provider</b>	<b>Amount</b>
Stockbrokers	€54,500,000
RBS Bonds	€4,000,000
Barclays Bonds	€3,100,000
Segregated Deposit Accounts	€9,500,000
Client Asset Pooled Accounts	€6,200,000
Third Party Bonds/PRSA Accounts	€10,000,000
<b>Total</b>	<b>€87,300,000</b>

- In respect of the €54,500,000 held with various stockbrokers the largest amounts are held with Merrion Stockbrokers for €35,200,000 and €11,300,000 with J&E Davy.
- Segregated Deposit Accounts are Fixed Term deposits with AIB, Bank of Ireland, EBS, Ulster Bank and Irish Life & Permanent.

### 19.2 Conclusions

While further detailed reconciliations and confirmations will need to be carried out and sought, the Inspectors believe that it may be possible to carry out these in a relatively expeditious fashion in respect of some of the categories listed above.

## 20. EXAMINATION NOT HELD

One intended examination under oath, that of Ms Michelle Donnelly, who worked in CHC in Finance and IT, and who the Inspectors firmly believed was likely to have information having a direct bearing on the investigation, did not take place. She was requested to attend before the Inspectors four times, and on three of these (in response to the first, second and fourth requests) a doctor's certificate evidencing ill health and inability to attend was furnished to the Inspectors by her solicitors.

As outlined in the Second Interim Report of 29 July 2011, the Inspectors first requested that Ms Donnelly appear before the Inspectors for an examination on 18 July 2011. However, this examination did not proceed as requested, because the Inspectors received from Ms Donnelly's solicitors medical certificates stating that she was unwell and not fit to attend the Inspectors for the Examination. Ms Donnelly was then requested to appear before the Inspectors on Tuesday 26 July 2011. However, neither did this examination proceed, since on 25 July 2011 correspondence was received from Ms Donnelly's solicitors enclosing a further medical certificate stating that she was unable to attend the examination due to ill health.

On 26 July 2011, the Inspectors wrote to Ms Donnelly's solicitors noting the medical certificate provided and outlining their continued interest in meeting with Ms Donnelly and her solicitors replied to this letter on 26 July 2011.

On 24 August 2011, the Inspectors again requested Ms Donnelly to attend for an examination, on 29 August 2011. This examination did not take place because Ms Donnelly's solicitors wrote to the Inspectors on 29 August 2011 advising that the Inspectors' request "came far too late to make such arrangements" for a meeting, and asserting that it was necessary that Ms Donnelly be advised beforehand of the nature of the Inspectors' queries "so that our client's willingness to co-operate may be harnessed effectively".

On 29 August 2011 the Inspectors again sought to arrange an examination with Ms Donnelly, writing to her solicitors to arrange a meeting on 1 September 2011. In this letter they stated that the matters outlined in the solicitors' most recent letter did not constitute any proper basis for Ms Donnelly declining to attend before the Inspectors for examination on oath or seeking to set down conditions for doing so, and noted that no reference had been made by her solicitors to the medical condition previously certified as preventing her from attending before the Inspectors. Again, this examination proposed for 29 August did not proceed

following a letter being received from Ms Donnelly's solicitors on 31 August 2011, citing her ill health as her reason for being unable to attend, and enclosing a further medical certificate.

Copies of all correspondence between the Inspectors and Ms Donnelly's solicitors are attached at Inspectors Exhibit 33.

## **PART D: MANAGEMENT OF CHC BUSINESS**

### **21. ARRANGEMENTS FOR MANAGEMENT OF CHC BUSINESS**

The Inspectors spent significant time in the course of their investigation considering how the consequences of the misconduct at CHC might be dealt with in the context of achieving a solution which would provide the best overall result for investors. However, the Inspectors were also aware that interests of differing categories of investors existed, e.g. the interest of those legitimately invested in property through an SPV as potentially contrasted with the interest of persons whose money was inappropriately invested in the same property. A major concern has been the potential for diminution of value in client holdings through the forced sale of properties which could result from lenders taking enforcement action on foot of a breach of a loan covenant. The Inspectors recognised that the prospect of an assumption of the liabilities of CHC by another firm or a capital injection of a size sufficient to cover its liabilities was small.

#### **21.1 Background**

On Saturday 16 July following their appointment by the High Court late on the previous evening the Inspectors, who were accompanied by a number of forensic accountants, went to the offices of CHC on Merrion Square, Dublin 2. On arrival the Inspectors met with staff of both CHC and Horwath Bastow Charleton (HBC). The Inspectors were informed that CHC had sought help from HBC who had then been retained to provide assistance in the day-to-day running of CHC and also to assist in ascertaining the scale of misallocation of funds, in reviewing the affairs of CHC, reconciling its books and records and endeavouring to regularise the affairs of the SPVs and other companies connected to CHC. The relationship between CHC and HBC was subsequently formalised with the signing of a letter of engagement for the provision of services by HBC on 28 July, as referred to in the second Interim Report of the Inspectors to the Court [Inspectors Exhibit 34].

#### **21.2 Initial Draft Proposal**

On 21 July at a meeting with HBC it was indicated to the Inspectors that HBC were in discussions with their own Board whereby Horwath Bastow Charleton Wealth Management (HBCWM), an authorised MiFID firm, might propose an acquisition of the assets of CHC. Over the next number of days CHC and HBCWM continued to engage in discussions while keeping the Inspectors informed. Late on 28 July a draft initial Heads of Terms was furnished



to the Central Bank and a copy of this was also attached to the Inspectors' second Interim Report to the Court [Inspectors Exhibit 35].

The Inspectors carefully considered, in conjunction with their legal and financial advisers, the details of the proposed arrangements submitted and a number of concerns and reservations arose. In summary, the Inspectors expressed concerns about the proposal, including as to the assumptions and projections on which it was based, the lack of detail, the legal basis for its implementation and CHC's ability to implement any proposal in light of its financial position and related considerations (including CHC's management's own participation in these matters).

Such concerns were expressed in the context of the Inspectors' role of carrying out an investigation into the affairs of CHC, in the course of which they endeavoured to consider what proposals for addressing matters coming to light in the course of their investigation might be most productive, while also mindful that they had no function or powers corresponding to those of examiners or administrators of a company. The primary responsibility for advancing such proposals remained with the Board of CHC.

### **21.3 Ongoing Discussions**

In the weeks that followed there were a number of meetings and exchanges of correspondence between CHC, HBCWM, the Central Bank and the Inspectors in which the implications and the various suggested advantages and disadvantages of different options, including the draft Heads of Terms referred to above, which might be available to mitigate the current, and minimise the potential future, damage for clients of CHC were reviewed.

It was clear that whatever option was chosen by CHC would need to take the following significant, but not exhaustive, set of factors into consideration:

- The misconduct with respect to clients' holdings, which have been dealt with elsewhere in this Report, had created a complex web of interactions and potentially competing interests between clients and creditors of CHC and its related property vehicles;
- The appointment of a liquidator over CHC could entitle or potentially precipitate lenders to enforce their security over properties held through the various SPVs/unit trusts. Any forced sale of properties following enforcement could result in lower sale prices than might be available on a later sale;

- The misconduct which had taken place, and the strong likelihood of the appointment of a liquidator, had undermined any ability of the Board to enter into a contract effectively for disposal or sale of the remaining assets and rights of the CHC in light of the possibility of a subsequent challenge to any such sale;
- The ability of a contractual or private law sale or other procedure, as opposed to a Court supervised process of resolution, to properly and transparently deal with the myriad of potential legal challenges and claims from creditors, clients who considered that their interests had been prejudiced for the benefit of or subordinated to those of other clients, employees, etc.
- The need to undertake substantial work to reconcile client accounts both within the Destiny structure and other client accounts, including the proper identification of flows of monies into and out of SPVs, other accounts, redemptions, etc.;
- The possible need to seek recourse against individuals and/or firms who, albeit unknowingly, had received payments which may have been taken improperly from other clients;
- The expectation of a necessity to deal openly and transparently with other issues, currently unknown to the Inspectors, likely to arise during the detailed reconciliation of individual client holdings and the preparation of proper reconciliations of the accounts of the various SPVs/unit trusts;
- The need to ensure any possible conflicts of interest are properly and fairly dealt with;
- The need to help and effectively deal with clients and assist in the proper processing of any resultant claims on the Investor Compensation Company Limited;
- The need to provide assistance to any other agencies which may need to investigate matters falling within their jurisdiction;
- The need to continue to properly and efficiently manage the client holdings, including property, held by CHC;
- The need to resolve all other outstanding issues, e.g. refreshing of the boards of the SPVs, putting appropriate legal documentation in place, resolve issues with respect to relationships with CH Asset Management GmbH, etc.;
- The dire financial circumstances of CHC.

In the course of the detailed review of options consideration was given to a scheme of arrangement under section 201 of the Companies Act 1963, the appointment of an examiner or administrator and the appointment of an equitable receiver. The Inspectors considered that, in each case, the reconciliation of client accounts and the establishment of the positions of clients, and potentially of classes of clients, which it is anticipated will be a very substantive exercise, would be necessary as a precondition to the preparation of any proposals.

In the case of a scheme of arrangement it was noted that in any event section 201 made provision for such a scheme of arrangement or compromise to be proposed by a liquidator if thought fit. With respect to the appointment of an examiner it was thought that the procedure was ill suited to an asset management company where substantial misappropriations and unauthorised transfers of client assets had taken place, particularly where there was no realistic prospect of a new investor. The MiFID Regulations made no provision for the appointment of an administrator to an investment firm, such as is provided for in the case of insurance companies under the Insurance (No. 2) Act 1983, and the Inspectors were advised that the concept would not be applicable to CHC. The possibility of appointment of an equitable receiver over the company was alluded to in a submission received from CHC on 2 September 2011. The Inspectors were advised that such appointments were uncommon and likely to be considered as a procedure only in the context of a wider scheme or proposal for resolution of all rights and interests of affected parties.

#### **21.4 Sub-Management Agreement**

On Friday 9 September 2011, the Inspectors facilitated a meeting attended by representatives of CHC, HBCWM, the Central Bank and the Inspectors. All had their legal representatives present.

At this meeting it was agreed that a sub-management agreement was the option which offered the best balance in terms of a) maximising a recovery of funds for the clients, b) addressing the legal concerns and possible legal challenges, c) providing transparency, d) ensuring fairness and e) mitigating, where possible, the other concerns listed above.

It was proposed by CHC that it would appoint HBCWM as a sub-manager which would manage all client holdings (property and non-property) under an agreement which envisaged the outsourcing to the maximum extent possible of the performance of the functions of the manager, CHC. HBCWM would continue its engagement with lending banks now acting as CHC's sole representatives with a view to a) informing them of the current difficulties and Investigation and b) assuring them that the appointment would facilitate the continuity of representation and interaction between the banks and the SPVs and Destiny unit trusts. HBCWM would endeavour to ensure that all lending banks had been met on at least one occasion before 21 October.

While all present at the meeting were conscious that there was no certainty that lending banks would take comfort from this arrangement, it was agreed that it would allow for continuity of engagement between the banks and HBCWM and would assist in stabilising the situation. HBC had already made contact with many of the lending banks, as provided for under the earlier letter of engagement.

## **21.5 Current Position**

CHC and HBCWM entered into a sub-management agreement as discussed above, which was formally signed on Thursday 13 October [Inspectors Exhibit 36]. However, since the meeting on 9 September, in anticipation of such agreement being formally entered into, HBCWM was authorised to meet, and has now met, all of the lending institutions with which CHC was dealing. While circumstances may change, HBCWM have reported that in most cases the banks are willing for the present to continue with their existing commercial funding arrangements, notwithstanding the possible appointment of a liquidator to CHC in due course.

## **PART E: FUTURE OF CHC**

### **22. Financial Position**

#### **22.1 Introduction**

The concerns that gave rise to the Central Bank's application for an order of the Court for the appointment of Inspectors in July 2011 included the following in relation to CHC's financial position:

- CHC's inability to make good on the guarantee provided by it under the Mezzanine Bond Fund,
- CHC's cashflow being strained and reliant on an overdraft facility of up to €200,000 in 2011,
- CHC's lack of ability to convert into cash significant amounts of debtor balances owing to it by various client property investment structures.

As the substance of these concerns has been confirmed and other critical issues have been uncovered by the work to date, it would appear to the Inspectors that, without a significant injection of funds and management restructuring, CHC is not in a position to sustain itself as an authorised investment firm or as a going concern.

#### **22.2 Letter to CHC regarding Financial Position**

The Inspectors wrote to CHC on 5 September 2011 [Inspectors Exhibit 37] expressing serious concerns about the financial position of CHC. As set out in that letter, the investigation, supported by the material provided by CHC, indicated that CHC could not demonstrate that it would be able to meet either a cash or balance sheet test of solvency. The cash test of solvency is that the company has or will have sufficient funds to meet its obligations to clients or creditors. The balance sheet test of solvency is that the value of current assets exceeds current liabilities.

In addition to the above, evidence suggested that at least €56m of client holdings had been inappropriately transferred from cash or equity investments of clients without their knowledge or consent and had been applied to a number of client property investments. It was apparent that, were such clients to demand from CHC a fraction of the assets they believe that CHC holds on their behalf (as the Inspectors believe they are entitled to), CHC would not be in a position to transfer the assets to the clients concerned.

#### **22.3 Forensic Examination of Solvency**

The Inspectors consider the following information relevant to the solvency position of CHC.

(i) Audited Financial Statements as at 31 March 2010

The latest filed accounts for CHC for the year ended 31 March 2010 [Inspectors Exhibit 38] show a Net Asset position of €3,877,347. The Independent Auditor's Report notes an emphasis of matter paragraph concerning CHC's ability to continue as a going concern, due to the unpredictable variation in the timing of the Company's cash inflows and the recoverability of debtor balances from property related entities.

Also included in the notes to the Financial Statements are details of a contingent liability. This relates to the Custom House Capital Mezzanine Bond Fund ("Mezz Bond Fund").

(ii) Custom House Capital Mezzanine Bond Fund

The Mezzanine Bond Fund was created and promoted by CHC, the terms of which are noted in the Financial Statements. CHC guarantees up to 100% of investor funds, plus a fixed return of 5-7% per annum, net of a management fee of 0.5% per annum.

As at 31 March 2010, the Financial Statements note that the exercise of the guarantee of investors could give rise to a maximum liability to the Company of €15,800,709. The Financial Statements further note that this liability could arise in a situation where the property investment funds in which the proceeds of the Mezzanine Bond Fund were advanced, defaulted in the repayment of these advances. As at 31 March 2010, the funds to which the proceeds of the Mezzanine Bond Fund were advanced were reported to be supported by properties valued at €115,625,000 (valuations as at 31 December 2009), of which the directors estimated that €11,932,876 would be available to Mezzanine Bond Fund holders, after taking account of senior bank debt, resulting in a contingent liability of €3,867,833 for CHC under the guarantee.

The current position on the Mezzanine Bond Fund is that €10.4 million is owing to investors and the Inspectors understand that as at 31 March 2011 the contingent liability amounted to €5,121,834<sup>58</sup>.

Since completion of the audit of CHC for the year ended 31 March 2011 has been suspended by MKO Partners, the auditors of the company, audited financial statements of CHC for that period have not been prepared and approved by the Board nor presented to an annual general meeting and filed in the Companies Registration Office.

(iii) Management Accounts as at 31 March 2011

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<sup>58</sup> The level of the contingent liability is inversely related to the net realisable value of the underlying properties.

Management Accounts provided by CHC for the year ended 31 March 2011 [Inspectors Exhibit 39] show the following balances:

- Bank Current Accounts €1,261,315;
- Deposit Accounts €33,163; and
- Ulster Bank Debenture Account €360,000.

(iv) Management Accounts as at 30 September 2011

Management Accounts for CHC for the six month period ending 30 September 2011 prepared in conjunction with Horwath Bastow Charleton (HBC) [Inspectors Exhibit 40] disclose total income of €1,069,000 net of commission payable to third parties of €170,000 and an increase in bad debt provision of €802,000. Total operating costs amounted to €1,980,000 resulting in a loss for the period of €911,000. This compares to a loss of €2,224,000 (after restatement) for the twelve months ending 31 March 2011.

CHC shareholder funds amounted to €3,015,000, a reduction of €911,000 from the position as per the Management Accounts for the year ended 31 March 2011.

The table below has been prepared to highlight the significant reduction in income and profitability of CHC business since March 2010.

*(Extracts from Audited Accounts as at 31 March 2010, Management Accounts as at 31 March 2011 & Management accounts as at 30 September 2011)*

	<i>Audited Accounts as at 31 March 2010 (12 Months)</i>	<i>Management Accounts as at 31 March 2011 (12 Months) – Restated as of 13<sup>th</sup> October 2011</i>	<i>Management Accounts as at 30 Sept 2011 (6 Months)</i>
Total Income	€5,943,874	€1,916,000	€1,069,000
Total Costs	€5,435,075	€4,140,000	€1,980,000
<b><i>Profit/(Loss) for the period</i></b>	<b>€508,799</b>	<b>(€2,224,000)</b>	<b>(€911,000)</b>
Liabilities	€4,567,734	€1,115,000	€834,000
<b><i>Shareholders Funds</i></b>	<b>€3,877,347</b>	<b>€3,926,000</b>	<b>€3,015,000</b>
<b><i>Cash at Bank</i></b>	<b>€1,677,951</b>	<b>€1,654,000</b>	<b>€443,000</b>

Trade Debtors (net)	€4,513,987	€2,880,000	€3,112,000
Trade Creditor / Accruals	€2,354,765	€488,000	€783,000

Certain material liabilities which are excluded from the management accounts include:

- Mezzanine Bond Fund & Debenture Interest €1,054,000
- CHC Subordinated Loan Debt €360,000
- Funds due to PRSA's €209,000<sup>59</sup> (this relates an agreed rebate of CHC's management fees due to clients which is to be reinvested in the relevant clients' PRSA)

(v) Bank/Cash position

Cash at Bank has reduced by €1,211,000 during the period March – September 2011 however, the actual cash available to CHC as at 30 September 2011 amounted to only €83,000 as included in the Cash at Bank figure of €443,000 is the sum of €360,000 held representing money subscribed by debenture holders (under subordinated loan agreements), see below.

As total income continues to fall and losses are incurred the cash available to meet obligations as they fall due is also decreasing. It is clear to the Inspectors that CHC is unable to trade on an on-going basis without the working capital loans that are being provided to it by HBC at present.

CHC are projecting a deficit of expenditure over income of €211,000 for October (excluding HBC working capital loans).

(vi) Cashflow Forecast

On 10 October 2011, the Inspectors were provided with a cashflow projection [Inspectors Exhibit 41]. The Inspectors have summarised this cashflow projection below:

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<sup>59</sup> This figure may fall in view of a potential write-off of fee income upon which this is based.



*Summary of CHC/HBC prepared cashflow at 10 October 2011*

	<b>Sep-11</b>	<b>Oct-11</b>
	<b>Actual</b>	<b>Projected</b>
	<b>€</b>	<b>€</b>
Inflows (excluding HBC Funding)	87,305	91,257
Outflows	<u>(239,801)</u>	<u>(302,407)</u>
Surplus/Deficit	(152,496)	(211,150)
Opening Bank Balance	137,169	9,673
HBC Funding (Loan)	<u>25,000</u>	<u>205,000</u>
Closing Bank Balance	9,673	3,523

The Inspectors note the following in relation to the table above:

- The forecast indicates that CHC will have funds of €3,523 at the end of October 2011 (excluding the funds held in cash reserves), after the receipt of loan monies of €205,000 from HBC.
- The cashflows provided make reference to cash reserves of €414,000 (which have not been included in the table above) which the Inspectors understand relate to the two deposit accounts (an Ulster Bank Debenture Account and Bank of Ireland deposit account). These funds have not previously been considered part of available cash in earlier CHC cashflows and the Inspectors have concerns as to whether the majority of this cash is indeed available to CHC. The Ulster Bank Debenture Account contains €360,000 and relates to subordinated loan capital raised from clients. The raising of this subordinated debt was the subject of Central Bank concerns in 2010 and following an inspection on this issue the Central Bank requested that all contributors be contacted by CHC and offered to have it repaid. This was completed and the amount in this account represents money from those clients who decided not to request repayment. The Bank of Ireland deposit account contains €54,000 and relates to money being held separately by CHC to use to pay the interest amounts due on the subordinated debt and some other expenses.

- The following items do not appear to be included in the cashflows:
  - Mezzanine Bond Interest in the amount of €46,000 per month; and
  - Repayment of the working capital funding (loan monies) advanced by HBC (the forecasts include professional fees payable to HBC of €86,266 in October 2011).

(vii) *Cash test*

The cashflow analysis presented by CHC (assisted by HBC) shows a cash deficit of €211,150 in October 2011 before the receipt of working capital loans from HBC. The working capital money provided by HBC required to fund this deficit amounts to €205,000 in October.

CHC's closing current account balance in October is approximately €3,500.

CHC is increasingly reliant on working capital loans provided by HBC to fund its current expenditure as its income is insufficient to do so. This accumulating debt will have to be repaid. CHC also continues to accrue professional fees which are currently due to HBC and others. In addition, Mezzanine Bond Fund interest of €803,000 due to clients on 31 March 2011 has not yet been paid. Taking all of these matters into account, CHC will not be able to meet its debts as they fall due and thus the firm fails to meet the cash test rule.

(viii) *Balance Sheet position*

The Management Accounts as at 30 September 2011 include a Balance Sheet with Net Assets of €3.015m. The largest asset on this balance sheet is Trade Debtors which stands at €3.12m (after deduction of the bad debt provision of €3.58m). Trade Debtors are primarily made up of amounts due in respect of unpaid marketing and management fees. These fees are due from various UK and European property structures and large amounts of fees have been outstanding for a considerable period of time. These debts are unlikely to be paid in advance of the sale of the properties in question and then only after other debts have been discharged (including improperly invested monies). Thus the timing and ultimate recoverability of many of these debtor positions is in doubt.

CHC's auditors specifically referred to the recoverability of debtors in the audit report for the year ended 31 March 2010 and included an "*emphasis of matter- going concern*" note in respect of this. Given what has occurred within CHC, this concern is even more pertinent.

Accruals at 30 September 2011 were €512k, however, this excludes the Mezzanine Bond and Debenture Interest due of €1.054m as outlined at (iv) above suggesting that CHC has not been and is currently not in a position to pay this debt as it falls due. As stated above, the Mezzanine Bond Fund interest due on 31 March 2011 was not paid.

In the Inspectors opinion, when taking a realistic view on the potential recovery of the debtor balances based on the information currently available on the various property investments and including other accruals, in particular the Mezzanine interest (which is overdue for payment), the overall Balance Sheet position changes from a net assets position to a net liabilities position.

(ix) Other Issues

Having considered the serious financial issues affecting the Balance Sheet and Cashflows of CHC there are a number of other significant matters which in the Inspectors view impacts materially on the ability of CHC to continue as a going concern.

During the course of the investigation, the Inspectors have identified approximately €56 million of client holdings that were improperly transferred without the clients' knowledge. This largely consisted of cash, together with liquid equity and liquid bonds positions which were converted to cash, which was improperly transferred to syndicated property investments and used to finance other aspects of CHC's business. The actual details are included in the body of the Report. Should the clients demand that this cash is returned to them, CHC clearly is not in a position to repay this money now or in the near future to these affected clients. However, it should be noted it is possible a large part of these monies may be recoverable over time through the effective management of the property portfolio and/or the sale of the property assets.

The misconduct which has occurred within CHC and which is the main subject of this Report raises significant concerns regarding the credibility of the firm continuing in business. CHC cannot trade without both the financial and operational support of HBC and very few of the employees of CHC still remain in the business.

(x) Professional Indemnity Insurance

CHC currently does not have and cannot secure any professional indemnity insurance cover. The previous professional indemnity insurance policy in place lapsed in July 2011 and despite efforts by CHC to renew this insurance cover it was unable to do so.

## 22.4 Summary

The audited accounts for the year ending 31 March 2010 while outdated at this stage showed that CHC had a number of financial concerns at that time. This was clearly demonstrated by the Auditors including an “Emphasis of Matter” paragraph in their Audit Opinion section. Emphasis of matter paragraphs clearly shows any reader of financial statements that a company has matters of serious financial concern.

The current management accounts show how these financial problems have escalated and become more serious for CHC. CHC is currently trading at a loss and continuing to reduce its cash reserves.

There are two fundamental tests to determine if a company is solvent or not, the *Cash Test* and the *Balance Sheet* test.

- *Cash test: As outlined above, the Inspectors consider that CHC would fail the cash flow test as it cannot pay its debts as they fall due.*
- *Balance Sheet test: As outlined above, The Inspectors consider that CHC fails the balance sheet debt as its recoverable assets are less than its liabilities.*

The actual cash position continues to worsen and while HBC continues to provide working capital loans, CHC will not be in a position to meet its obligations as they fall due including paying back the loan money provided by HBC. In particular, a large part of the interest amount owing by CHC to Mezzanine Bond Fund clients and Debenture Loan holders of €1,094,000 as at 30 September 2011 was not paid as it fell due and CHC is currently not in a position to meet these obligations.

The Inspectors are of the view that current staffing arrangements at CHC are completely insufficient in order for it to continue operating. As mentioned above it is only because of the administrative support of HBC that CHC is able to currently continue to operate on a day to day basis. In order for clients’ positions to be accurately validated there will need to be adequate resources to reconcile all holdings. The Inspectors have been advised that this process could take up to six months to complete, so therefore during that period, in whatever form this takes, the availability of qualified persons to conduct such an exercise will be critical.

CHC has acknowledged to the Inspectors, in correspondence dated 2 September 2011 [Inspectors Exhibit 42], that it cannot credibly continue to provide investment services. From the matters uncovered by the Inspectors, a serious lack of credibility attaches to any continuation of business that the directors of CHC might envisage. The investigation of CHC by the Inspectors has validated significant concerns related to the manner in which the business of CHC has been conducted which has led to approximately €56 million of client holdings (largely cash and equity holdings) being improperly transferred without the clients' knowledge.

## **22.5 Conclusions**

CHC currently requires significant working capital loans from HBC to fund its expenditure which it will have to repay. Also CHC continues to accumulate unpaid fees which are owing to HBC. CHC is operating without sufficient numbers of employees and a properly functioning Board of Directors. Relations with CHC clients are currently being managed in the main by HBC. Significant claims are likely to be made against CHC by various clients and creditors the claims of many of whom are likely to be well founded. CHC currently does not have and cannot secure any professional indemnity insurance cover. Many debtor positions are not readily recoverable and cannot be relied on in the near to medium term to be converted to cash. CHC has also failed to pay Mezzanine Bond interest as it fell due and is currently unable to do so. CHC cannot currently meet any significant requests from clients for the repayment of their holdings and it appears to the Inspectors that the pursuit of such requests is currently only forestalled by the directions imposed by the Central Bank and the pending completion of this Report.

Based on all of the foregoing, the Inspectors are of the view that CHC is insolvent and in the interests of clients and other creditors a liquidator should be appointed immediately to wind-up its affairs.

## **PART F: GENERAL CONCLUSIONS**

### **23. GENERAL CONCLUSIONS**

In the introduction to the Report, the scale of the misconduct of CHC was summarised, with the body of the Report providing more detail on specific issues. The exact sums of money taken directly and indirectly from clients by CHC and placed into property investments and/or used to meet other cash needs cannot be precisely stated without a detailed reconciliation of clients' holdings. However it is clear that this amounted to in excess of €56 million. This does not include the funds owed to Mezzanine Bond holders, which amount to an additional €10.4 million (exclusive of interest). There was a systematic and deliberate misuse of assets and cash belonging directly or indirectly to clients of CHC. This misuse was deliberately disguised by CHC through the use of false accounting entries and the issue of false and misleading statements to clients.

#### **23.1 Origin of the Misconduct**

The origin and rationale behind the misuse of client funds would appear to be relatively straightforward. CHC commenced promoting property investment to its clients around 2004. At first successful, CHC committed to additional and bigger property projects and, in the view of Mr Cassidy, acquired a reputation in Europe as a good partner for such transactions. Mr Cassidy indicated that this was reflected in developers requiring a smaller initial deposit (down from 10% to 5%) from CHC when setting up property deals. However, CHC committed itself to a number of property projects and placed deposits in advance of securing the required equity from prospective investors. When the property crisis emerged in 2007 CHC found that expected investment from prospective investors was not forthcoming. As the flow of fresh investment into property projects ceased, in fear of loss of the initial deposit and damage to its reputation, CHC sought to cover the investment shortfalls through the creation of products such as the Mezzanine Bond and eventually through the misuse of client holdings described in the report.

CHC generated significant commissions from the property investments it made on behalf of its clients. By way of example, on a property valued €50 million, financed with €15 million of client investments and €35 million from bank borrowing, a 5% marketing/placement fee based on the value of the property would generate an initial fee of €2.5 million. Ongoing property management fees (typically 5% of gross rental income) and client account fees would also be generated in due course. This flow of income would also be lost should the property investment fall through.

Notwithstanding the relatively straightforward explanation of how the shortfalls in the financing of property investments occurred, the consequences of the actions taken by CHC to fill those shortfalls are complicated.

### **23.2 Impact of the Misconduct**

The Inspectors have been advised and consider that it would take significant experienced resources several months to resolve all individual client positions. It should also be noted that a full reconciliation may prove difficult if not impossible where a proper documentation and a proper cash trail cannot be confidently established. As a detailed reconciliation of the trusts held under the Destiny structure, client asset accounts and the accounts of the SPVs is undertaken, other issues may arise.

The assets of some individual clients (in particular those held directly in the name of clients with stockbrokers) will be easier to identify than others. While in certain cases an early disbursement of assets to clients may thus be possible, in others it will involve a more lengthy process. The Inspectors believe that some client money will be lost (e.g. the value of Los Collados, an uncompleted Spanish property development, also known as Destiny 140 'Commercial,' is considerably less than €9 million, which represents the level of misallocated client money which was used to finance it).

In considering the level of difficulty which will be involved in achieving a full reconciliation of the application and possible recovery of misused client holdings it needs to be borne in mind that misallocated monies were used for a variety of purposes. Examples which were uncovered by the Inspectors included;

- Payments to meet cash demands of other clients;
- Loans to or investments in property projects;
- Payments in respect of commissions to third party introducers;
- Payment of day-to-day bills of property projects, e.g. court demands, maintenance, builders, etc.;
- Payments of commissions to CHC;
- As a fixed term deposit (in the name of CHC) which was used as security for a loan to CHC which was subsequently used to finance a property project;
- A temporary loan to third parties.

The reconciliation may be further complicated by the poor quality, and in some cases possible absence, of proper legal documentation covering various transactions undertaken by CHC.

### 23.3 Custom House Capital Limited (“CHC”)

CHC is authorised under Regulation 11 of the European Communities (Markets in Financial Instruments) Regulations 2007 (“the MiFID Regulations”). Responsibility for the proper management and control of a MiFID investment firm, and the integrity of its systems, rests with the board of directors and its senior management. Ethical behaviour and transparency in business dealings are key values expected of the board and senior management of such a firm. An investment firm must ensure that particular attention is continually given to corporate governance, oversight arrangements and its internal controls. On a regular basis, an investment firm should evaluate and monitor the adequacy and effectiveness of its policies and procedures, systems, internal control mechanisms and arrangements, in place (ensuring they are kept up to date) and take appropriate measures to address any deficiencies that may arise.

The Inspectors are satisfied based on the matters described in this report that CHC’s board of directors and its senior management failed in their duties to clients and allowed the company to operate with inadequate internal controls over a significant period of time. The following significant failures occurred regarding the operation of CHC’s business activities:

- (a) Inadequate resources and attention given to compliance matters;
- (b) Facilitating a culture of evasion of internal controls and override of such controls;
- (c) Inadequate skills, understanding, and challenge at board level regarding the business operations of CHC;
- (d) Inadequate control at board level of all business operations of CHC;
- (e) Inadequate internal accounting systems and insufficient resources dedicated to maintaining these systems;
- (f) A disregard for the interests of clients and the trust placed by clients in CHC;
- (g) A disregard for the property rights of clients whose assets CHC were managing and inadequate controls over the safeguarding of these assets from loss, damage or misappropriation;
- (h) A failure to maintain appropriate standards of corporate governance and a failure to address the dominance and significant influence with which the CEO managed the business;
- (i) A lack of ethical and responsible decision making;
- (j) Provision of false and misleading information to the Central Bank;



- (k) Concealment of information from the Central Bank;
- (l) Misrepresentation of client holdings on client statements issued.

The Inspectors are satisfied that CHC deliberately adopted and pursued processes, policies, and procedures that facilitated misconduct of the nature and on the scale described in this report taking place.

#### **23.4 ARF Management Limited (“ARF”)**

During the course of our investigation, the Inspectors became aware of a number of issues concerning ARF potentially of relevance to investments promoted by CHC to its clients. ARF is a firm owned and controlled by Mr Harry Cassidy with no separate operational staff of its own which used the resources of CHC to carry out its accounting and operational work. However, neither ARF nor the business operated by ARF is authorised or supervised by the Central Bank. Certain issues in respect of ARF which came to the attention of the Inspectors will be the subject of a separate communication to the Court pursuant to Regulation 171(1).

#### **23.5 Expenses of and fees relating to the investigation**

Pursuant to Regulation 170(1) of the MiFID Regulations the expenses of and incidental to the investigation shall be defrayed by the Central Bank and the Court may direct that any person dealt with in the Report shall be liable, to such extent as the Court may direct, on the application of the Central Bank to repay the Central Bank any expenses or fees incurred.

19 October 2011

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George Treacy

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Noel Thompson

**Inspectors appointed by the High Court pursuant to Regulation 166 of the European Communities (Markets in Financial Instruments) Regulations 2007**