Regulatory issues highlighted by the collapse of Secured Energy Bonds

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Issue raised; a lacuna in the jurisdiction of the Financial Ombudsman (1)

Introduction

The well-documented collapsed of Secured Energy Bonds has left hundreds of investors facing a financial black-hole.

Almost one thousand people invested in Secured Energy Bonds, a mini-bond that promised a 6.5% annual return. The bond, on the face of it, was attractive as it promised a high return in an otherwise low-yield environment. The bonds promised 'sustainable and predictable' investments.

Unlike a usual corporate bond, mini-bonds are not generally rated by credit-reference agencies. Mini-bonds are, in fact, unregulated and ineligible for the Financial Services Compensation Scheme, which leaves investors vulnerable if the issuing company collapses, which is what happened in this case.

Investors placed a combined total of £7.5 million into Secured Energy Bonds, but stopped receiving interest payments in January 2015, when Secured Energy Bond PLC was placed into administration.

As these bonds are unregulated, the prospect of investors recovering their money is bleak. It now appears that 20% of the investments – a total of £1.5 million – was spent on launch costs, whilst much of the remaining funds were transferred to a parent company, CBD Energy Limited, domiciled in Australia.

Due to a lacuna in the regulatory environment for these types of financial product, investors face a real risk of not being able to recover any of their misappropriated funds.

Lacuna

It is absolutely critical to appreciate the increasing role of the Financial Ombudsman Service as the only practical avenue of redress for consumers who are not wealthy. However, the Financial Ombudsman only has jurisdiction to deal with claimed losses up to a maximum of £150,000.

As such, consumers have to look to the courts to obtain redress for any losses which exceed this amount. Unfortunately, at the present time it is simply not commercially viable for a consumer to take a case to court unless the consumer can obtain funding from a third party. This is only likely to be the cases in cases worth at least £500,000 in damages, and thus a lacuna has developed for consumers with losses in between these two amounts.

The lacuna developed because of the impact of the changes implemented by the "Jackson Reforms" and contained in the Legal Aid, Sentencing and Punishment of Offenders Act 2012 and implemented in April 2013. To illustrate the impact of the reforms, it is helpful to understand the before-and-after position.

Pre-April 2013

Prior to April 2013, if the claim value exceeded the jurisdictional limit of the Financial Ombudsman – and thus a disgruntled consumer had to consider the possibility of court proceedings in order to seek redress – the consumer had certain options available in terms of minimising the cost and risk of undertaking formal litigation through the courts.

Issue raised; a lacuna in the jurisdiction of the Financial Ombudsman (2)

In terms of legal costs, a consumer could enter into a "no win-no fee" arrangement with a solicitor. In the event that the consumer lost the case, no fees were payable to his solicitor. At the same time, the consumer could enter into by an After-The-Event-Insurance product which was payable by means of a deferred and conditional premium. This insurance would cover the financial institution's legal costs in the event that the consumer's complaint was not successful. As the premium was deferred and conditional, in the event that the case was unsuccessful, no monies were payable to the insurer in respect of the insurance premium.

In the event that the consumer won his or her claim against the financial institution, then the consumer would recover damages from the financial institution, plus reasonable legal costs which included the After-The-Event-Insurance insurance premium and any success fee payable to the solicitor under the "no win-no fee" arrangement.

This regime helped ensure two things;

a) a consumer with very limited means could make a claim against a financial institution; and

b) If the potential claim exceeded the financial limit of the Financial Ombudsman's jurisdiction, any consumer with a sufficiently meritorious complaint could make a claim against a financial institution through the courts without the risk of being ordered to make a large costs payment if the claim was not successful.

As (i) insurers did not receive any payment if the claim was unsuccessful as well as having to pay the financial institution's costs, and (ii) the consumer's solicitor would not receive any payment if the claim was unsuccessful, the system ensured that only genuinely meritorious cases received financial backing from insurers and solicitors.

Post-April 2013

Under the new regime, even if the consumer wins at court then he or she will not be entitled to recover the cost of the After-The-Event-Insurance premium or the solicitor's success fee. The premium and the success fee must be paid from the Claimant's damages.

As the After-The-Event-Insurance product has to insure against the risk of the insurer being ordered to pay the (often considerable) cost of the financial institution's solicitor, the premium can be prohibitive. As this has to be deducted from any damages recovered before a return is seen by the consumer, it often means that it not practically possible to pursue claims through court in respect of claims of between £150,000-£500,000, simply because any recovery would be completely eroded by payment of the premium.

Whilst it is, of course, possible for any consumer to chose to litigate without the benefit of an After-The-Event-Insurance policy, it is seldom appropriate for a consumer to do so. The average legal costs incurred by a financial institution in contesting a claim to trial would be financially ruinous for the vast majority of consumers, should their claim be unsuccessful and they be ordered to pay such costs.

As such, consumers with complains valued in this lacuna are often faced with no alternative but to expose themselves to the risk of losing the entirety of their assets if they wish to litigate against a financial institution. There is no proper access to justice where such a lacuna exists.

Other issues

There is also a lacuna between the respective jurisdiction of the Financial Ombudsman and the Pensions Ombudsman. There is a Memorandum of Understanding between the respective Ombudsmen that is intended to assist in delineating which type of dispute will be dealt with by each ombudsman. However, a claim against an adviser in respect of advice concerning the transfer out of benefits from an occupational pension scheme cannot be investigated by either ombudsmen for want of jurisdiction.

We are also aware of situations where complaints against D&O Policies by directors have been rejected by FOS, on the basis that the directors are not acting as consumers. This clearly gives rise to the same issues discussed above as regards a lack of access to justice for any directors (particularly of SMEs) who cannot afford to challenge the insurer through the courts but also cannot complain to the Financial Ombudsman.

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"Martin Woodford is deemed to be a 'real class act' and complimented on his client service and high quality of work. He comes particularly recommended for his significant experience in financial services disputes."

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