E&G **ECONOMIDES** LLC

INVESTMENT FIRMS - CAN THEY **GET AWAY** WITH BAD PRACTICE?

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Since the accession of Cyprus in the European Union in 2004, the country has seen an unprecedented explosion in Foreign Exchange (FOREX) firms and other financial institutions setting up their operations on the island as Cyprus Investment Firms (CIF).

That is mainly attributed to two main factors. Firstly, Cyprus offers one of the lowest corporate tax rates in the European Union at just 12.5%. Secondly, Cyprus Securities and Exchange Commission (CySEC) the country's financial regulatory Agency is a member of the committee of the European Securities and Market Authority (ESMA), which aligns its regulatory framework with the European MiFID Regulation.

MiFID Regulation provides for the so called "passporting principle", allowing firms established in an EU and EEA member state to offer cross-border services to clients and to set up branches in any another EU and EEA country.

On one hand, the combination of these incentive factors allow for an institution to be taxed under the Cyprus tax regime, while still being able to provide its services to clients and carry out its operations throughout the European market.

On the other hand, from an investor's perspective, there has always been an attraction to neutral tax on forex gains and tax exempt gains resulted from trading in securities. However, in an era of negative bank interest rates, trading activity and demand for financial products has grown even more. Further, the advancement and the infiltration of trading platforms through mobile phone apps and websites into the daily life of retail investors has made trading possible and accessible to almost anyone.

As popularity and audience has grown for financial products such as forex and securities trading, spread betting and CFDs, so has financial exposure and risk. As a result, over the recent years, a culture of "day traders" has been developed, having reached its climax point amid the pandemic of COVID-19, where retail demat account openings hit an all-time high.

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Consequently, there has been an alarming rise in legal disputes, particularly in relation to high risk and volatile financial products such as CFDs, binary options and forex pairs.

Disputes usually arise when brokers and financial institutions adopt a number of practices in order to lure clients and extract their money, such practices have been deemed by lawmakers to be illegal and in some cases fraudulent.

- Fraudulent sales pitch as well as dishonest and empty promises
- Aggressive and improper marketing practices (offering bonuses, gifts that may lead to a Ponzi scheme)
- Provision of misleading information and fabricated reports (signal selling)
- Mis-selling of financial products
- The creation of “fake alarm situations” in order to pressure clients to provide further funds
- Execution of unnecessary trades or encouraging high-risk investments to rack up trading commissions at the client's expense
- Deliberately encouraging clients to deposit and lose funds by not hedging client positions, meaning that brokers are acting more like a bookie rather than a broker
- Inadequate disclosures of conflict of interest
- Arbitrarily manipulate quoted rates in order to trigger limit or stop loss orders.
- Prohibiting access to the platform rendering the withdrawal of funds impossible.
- Dysfunctional platforms or delayed execution of orders resulting to loss of profit
- Wrongful/ Inadequate client categorisation processes
- Ponzi and pyramid schemes
- Deception or forgery
- Excessive and prohibited leverage on trades

In our experience, the consequences of such practices will begin to emerge when trade positions are forced closed as a result of a position that has overextended client’s available margin. Brokers will normally attempt to contact the client and request further funds in order to “keep the account alive”. If further funds are not provided, brokers put client’s account on stop and automatically block all open positions. As a result, the client’s initial deposit could be entirely depleted. In some cases, account losses can go well beyond the initial investment, meaning that investors may find themselves in the unfortunate position owing money to the broker.

In a potential dispute, the complexity of trading in financial instruments can be a benefit to brokerage firms and financial institutions. Nonetheless, European law recognizes the imbalance of power between financial institutions and investors/clients and in order to mitigate such a situation,the MiFIR Directive came into force, a legislative framework designed to strengthen investor protection. The Directive is comprehensive enough to cover every stage of the investment (before, during and after the trading) providing in that way greater protection rights to investors.

In case of violation of the Directive by a CIF/Brokerage Firm, investors can seek broker’s liability for their losses on the market. Investors have several potential options to consider in pursuing their claims against brokerage firms, which may be combined to achieve the desirable outcome.

Such options include:

File an official complaint to the CIF-Brokerage Firm

By filing a complaint form to the CIF an investor will a unique reference number. This unique number reference will be used for all future

communications and further complaint that might be submitted to the Financial Ombudsman and/or to CySEC.

Firms are required to acknowledge receipt of the complaint within five days and respond to the complaint form submitted within two months.

File an Official complaint to CySEC

Although, CySEC does not have restitution powers and does not award compensation to investors, an official complaint against a CIF may result in a partial or complete license suspension of the Brokerage firm.

Contact the Financial Ombudsman

The Financial Ombudsman is an independent service for settling disputes between CIFs and other financial institutions and their clients. Clients/Investors can file a complaint and seek mediation for possible compensation.

However, for a case to be eligible for a mediation under the Financial Ombudsman services, it must not be for a claim over €250.000 (two hundred and fifty thousand EUR) and it must be submitted to the Financial Ombudsman within four months of receiving a final response from the CIF.

Commencement of litigation

Litigation shall always considered as a last resort. However, in our experience most of the times it is the only way investors/clients can receive partial or full compensation. Nonetheless, financial misconduct, negligence and fraud cases are challenging by nature and each case shall turn on its own facts. If a case has a reasonable chance of success, then it needs serious consideration and guidance by professionals specialized in the field.

The purpose of this article is to provide a general guideline on the subject and not to be considered, in any way, as legal advice. It is advisable to seek professional and legal advice on the subject before proceeding with any general information provided to you. For further clarifications and advice please contact us at legal@economideslegal.com

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