



EVERSHEDS
O'DONNELL SWEENEY

DUBLIN SOLICITORS' BAR ASSOCIATION

Misselling & Misleading:
Acting for the Promoters of Financial Products

2 June 2010

Focus of the discussion

- Duties and liabilities of the promoters of financial products
- Much closer regulatory and public scrutiny in more difficult economic times
- Recent cases
- Main areas to consider
 - Liability of investment managers
 - Key issues for investors (and promoters)
 - Legal & Regulatory Compliance

Recent Cases

SMDF v Bloxham

- Investment of €8.4m by SMDF in bank bond promoted by Bloxham, arranged & dealt by Morgan Stanley
- Bond down-graded due to financial crisis - early redemption event
- Lost 97% of its value, redeemed in June 2009 (earliest date this could be done without loss to Morgan Stanley)
- SMDF allege that Bloxham
 - failed to explain nature of the bonds, and
 - recommended the investment without understanding its nature and risks
- Bloxham claim that Morgan Stanley
 - Caused or contributed to the losses
 - Did not warn of early redemption possibilities

Recent Cases

Kilmartin v Bank of Ireland

- Plaintiffs advised by BoI to take out 15 year endowment mortgage rather than traditional annuity mortgage
 - More secure
 - Greater return – “nice little nest egg”
- Interest-only mortgage, where the capital is intended to be repaid by endowment policy at end of term
- Basic premise – rate of growth of investment exceeds rate of interest on loan, in fact led to €4,864 shortfall
- Negligent misrepresentation - €16,000 damages
 - Documentation failed to highlight risks
 - No evidence they were warned of potential downside
- Bank of Ireland intend to appeal to High Court

Liability of Investment Managers

- Investment managers owe a number of separate duties to their clients – each a potential head of claim
 - Duty of care / Negligence
 - Breach of fiduciary duty
 - Breach of contractual duty
 - Misrepresentation
 - MiFID Regulations
 - Financial Services Ombudsman
 - Vicarious liability

Liability of Investment Managers (cont'd)

Duty of care / Negligence

- . Duty, breach, causation, loss

- . Can usually establish duty due to investment manager / client relationship

- . Standard of care
 - Proficiency of an ordinary skilled person in that sector
 - Regulatory standards are also relevant
 - Are investment managers “professionals”?
 - Strict attitude of Irish courts to professional negligence – Wildgust v Bank of Ireland

Liability of Investment Managers (cont'd)

Breach of fiduciary duty

- . Duty of loyalty – 4 components
 - No conflict of interest between client and investment manager
 - No unauthorised profits at client's expense
 - No conflict of interest between duties to different clients
 - Duty of confidentiality

- . Damages, rescission, account for profits or an injunction

- . Availability of equitable remedies makes this a very serious head of claim

- . Can limit scope of duty, but only to a certain extent

Liability of Investment Managers (cont'd)

Breach of contract

- Investment manager / client relationship usually founded on contract
- Express terms, as well as those implied by the parties, at common law or by statute
- May contract to exercise skill and care, but should never guarantee a particular result / rate of return
- Sale of Goods & Supply of Services Act 1980 – must provide service with “due skill, care & diligence”
- Courts can imply terms based on regulatory standards
- Exclusion clause therefore critical
 - Clear & unambiguous (*contra proferens*)
 - Exclude or limit liability for negligence

Liability of Investment Managers (cont'd)

Misrepresentation

- . Claimant must show
 - Representation of fact
 - That was untrue
 - Induced to enter the contract as a result

- . Remedies at common law and under statute
 - Common law
 - . Innocent - rescission
 - . Negligent – tort of negligent misrepresentation
 - . Fraudulent – tort of deceit

 - Statute
 - . 1980 Act - liable for damages unless they had reasonable grounds to believe it was true
 - . Can award damages in lieu of rescission

Liability of Investment Managers (cont'd)

MiFID Regulations

- . Applies to investment managers who
 - Provide investment advice
 - Conduct discretionary portfolio management, or
 - Execute client ordersin relation to financial products

- . 3 categories of client with varying levels of protection
 - Retail
 - Professional
 - Eligible counterparty

- . Conduct of business rules & administrative sanctions

- . Finding of a “prescribed contravention” can lead to wide variety of sanctions

Liability of Investment Managers (cont'd)

Financial Services Ombudsman

- Complaints by consumers about regulated financial service providers
- Where internal procedures / mediation unsuccessful, can investigate the complaint
- Upon making decision, can direct provider to
 - Rectify conduct complained of or its consequences
 - Provide explanations for the conduct
 - Change the practice concerned
 - Pay compensation (up to €250,000)
- Generally, case histories indicate a “pro-consumer” stance on the part of the Ombudsman

Liability of Investment Managers (cont'd)

Vicarious Liability

- Where blame lies with a particular individual within an organisation, will often hold that the firm is vicariously liable if they were following accepted practice
 - Concerns about “rogue” traders
- Partners in partnership will be jointly and severally liable
- Directors – unlikely that company will be held vicariously liable for their acts, but often entitled to indemnity from the company for their acts
 - Risk can be mitigated by D&O insurance policy

Legal & Regulatory Compliance

Key Issues for Investors

- Investors will have particular appetite for risk/reward
- Promoter must insure the investor is fully informed & that the financial product matches the investor's attitude to risk
- As we have seen from Kilmartin v Bank of Ireland, crucial that the investment manager properly **documents** key issues & risk profile
- Regulation of provision of investment services / advice by solicitors
- "Top ten" investor issues

Legal & Regulatory Compliance (cont'd)

"Top ten" investor issues

- Capital guarantees
- Limited liability
- Risk profile
- Rate of return / commissions
- Track record
- Market sector
- Length of investment
- Exit mechanism
- Taxation
- Ethical/environmental concerns

Legal & Regulatory Compliance (cont'd)

- **Investment Vehicle** – do the legal characteristics of the SPV chosen fit the financial product?
 - Limited liability / partnership
 - Maximum number of members
 - Place of incorporation
 - Form of interest (shares / loan notes / partnership)
 - Transferable or “locked in”?

Legal & Regulatory Compliance (cont'd)

Prospectus Regulations

- . Do the Prospectus Regulations apply?
 - Shares / Bonds / Other securities?
 - Freely transferable?
 - Is the investment a UCIT?
 - Is the total consideration limited to >€2.5 million?

- . Is there an exemption from the obligation to publish a prospectus? (Regulation 9)
 - Offer made solely to “qualified investors”
 - Offer made to fewer than 100 persons
 - Minimum consideration payable is €50,000+
 - Denomination per unit of €50,000+
 - Total consideration for offer limited to <€100,000

- . Limited exemptions if shares admitted to trading on “regulated market” (Regulations 11 and 13)

Legal & Regulatory Compliance (cont'd)

UCITS & Non-UCITS

- EC (UCITS) Regulations 2003 – the investment vehicle must meet the following criteria:
 - Sole object of undertaking is collective investment of capital raised from the public in the EU
 - Investment must be in transferable securities (shares, bonds, negotiable instruments or other liquid financial assets) listed on a “regulated market”
 - Undertaking must operate on principle of risk-spreading (number of separate investments in diverse companies / sectors)
 - Units held by each investor must be capable of being repurchased or redeemed out of the undertaking’s assets upon request by the investor



Legal & Regulatory Compliance (cont'd)

UCITS & Non-UCITS

- UCIT may be constituted as:
 - Investment company (fixed or variable share capital)
 - Unit trust
 - Common contractual fund
- UCITS Notices – must publish a simplified and full prospectus, outlining objectives and specific investment policy

Legal & Regulatory Compliance (cont'd)

UCITS & Non-UCITS

- Collective investment undertakings which fall outside of UCITS Regulations are also supervised by the Financial Regulator
- UCITS Regulations do not apply to an undertaking where:
 - It is closed-ended
 - It raises capital without promoting sale of its units to members of the public in the EU
 - Its units may only be sold to public outside the EU under its constitutional documents
- Unit trust, common contractual fund, investment company or investment limited partnership
- NU Series of Notices – must publish a prospectus with sufficient information for investors to make informed decision

Legal & Regulatory Compliance (cont'd)

Revenue Compliance – SSAPS

- Business owners who want to control their investments
- Special approvals to ensure they are bona fide to provide relevant benefits, not just tax avoidance scheme
- Always “small” where 65%+ of value of investments relate to provision of benefits for directors of sponsoring employer
- Trustees must include Revenue-approved “Pensioner Trustee”, who must give prescribed undertakings
- All investments on arms-length basis, powers to invest are circumscribed in some areas (e.g. no loans to members, no “self-investing”)

Legal & Regulatory Compliance (cont'd)

Revenue Compliance – ARFs

- Allow individuals to re-invest their pension funds, withdraw regular income or lump sums when required
- Must be managed by QFM
- QFM must obtain
 - Certificate from the previous Life Office, Scheme Administrator or PRSA Provider
 - Declaration from beneficial owner confirming
 - Name, address, tax reference number
 - Beneficially entitled to assets transferred
 - Assets currently held in RAC, PRSA, or approved occupational pension scheme
 - They have met AMRF requirement or have a “specified income”, or are over 75

Unregulated “Schemes”

- In all cases, even if none of the above regulatory consents / approvals are required, investment managers must still comply with, depending on the vehicle
 - Companies Acts 1963 – 2009
 - Partnership Act 1890
 - Limited Partnership Act 1907

QUESTIONS?

The material contained in this presentation is for information purposes only and does not constitute legal advice. Specialist advice should always be sought about particular circumstances.



EVERSHEDS
O'DONNELL SWEENEY

Thank you for your time and attention

Contact:

Abigail St. John Kennedy, Partner, Corporate

Tel: 01 6644385

Email: akennedy@eversheds.ie

Stephen D'Ardis, Solicitor, Corporate

Tel: 01 6644914

Email: sdardis@eversheds.ie