

**C L I F F O R D
C H A N C E**



**REGULATORY AND PRODUCT PLACEMENT RISK MANAGEMENT
SRP CONFERENCE, 2 NOVEMBER 2017**

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REGULATORY AND PRODUCT PLACEMENT RISK MANAGEMENT

INTRODUCTION

Where financial products do not perform in line with expectations, regulatory and litigation risk is increased. The global financial crisis has resulted in a sharp rise in allegations of misselling.

Since the crisis:

- Unprecedented levels of regulatory enforcement action worldwide
- The introduction of tighter regulation on banks and financial institutions
- Widespread civil claims that have sought to rely on regulatory breaches and the findings of regulators

REGULATORY AND PRODUCT PLACEMENT RISK MANAGEMENT

LIABILITY MANAGEMENT IN PLACING STRUCTURED PRODUCTS

Identifying misselling risk at the outset is key. What should be your initial considerations?

- How complex are the products you are placing into the market?
- How sophisticated are your target investors?
- Are you selling on an advised basis or an execution only basis?
- How tightly regulated is / are the market(s) in which you and your investors operate?
- How have regulators and courts in the relevant jurisdictions approached misselling in the past?

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PUTTING IN PLACE THE APPROPRIATE PRACTICES TO MANAGE YOUR RISK

Whether or not a product has been missold will depend on the precise circumstances of the sale, but there are steps you can take to mitigate your risk appropriately.

- You should ensure:
 - your target market is not fundamentally unsuitable for the type of product you are offering
 - you understand the regulatory requirements that will apply to the sale
 - your marketing documentation is accurate, presents products in a balanced manner and contains suitable disclaimers
 - your contractual documentation contains a robust suite of appropriately-worded duty defining clauses and exclusion clauses
 - members of staff that engage with customers understand the products they are selling and are properly trained as to the risk of misselling, so that they do not act in a manner that will undermine your ability to rely on the wording in your contracts
 - your record-keeping policies mean that you collect and then retain signed copies of customer contracts, so that you can rely on them when required

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EXAMPLES OF REGULATOR INTERVENTION

- **Keydata / Life Settlement Products (United Kingdom, FCA):**
 - Keydata breached Principle 1 (integrity) and Principle 4 (relations with regulators) of the FCA's Principles for Businesses in failing to manage conflicts of interest, failing to perform adequate due diligence and recklessly failing to ensure that Keydata took steps to explain the risks of the products
- **Lehman Brothers “Principal Protected Notes” (Belgium, Tribunal of First Instance):**
 - The Court found that the distributor and managers did not comply with the Belgian Market Practices Act
- **Principles on the sale of Credit-Linked Notes to retail investors (Germany, BaFin):**
 - Following an industry consultation, BaFin suspended its plan to ban the sales, but issued a series of principles aimed at limiting the target market for the notes. This included a minimum threshold for investment of €10,000 and specific requirements in relation to the assets underlying the notes

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MIS-SELLING LITIGATION IN ENGLAND AND WALES (1)

Generally banks have been successful in the English Courts in defending mis-selling claims.

- *Springwell Navigation Corp v. JP Morgan Chase Bank* [2010] EWCA Civ 1221
 - The case concerned GKO-Linked Notes, which lost their value during the financial crisis in the late 1990s
 - Springwell issued a wide-ranging claim against JP Morgan that encompassed a number of different causes of action (breach of contract, negligence, breach of fiduciary duty, negligent mis-statement and misrepresentation)
 - The case confirmed the English doctrine of contractual estoppel. If the parties have agreed certain matters under contract (e.g. that the investors understand the risks in the products) they may be estopped from subsequently alleging the contrary
- *Zaki v. Credit Suisse (UK) Ltd* [2013] EWCA Civ 14
 - The case concerned a number of structured financial products: 'Callable Bullish Notes', 'Trigger Notes' and 'Reverse Convertible Notes', which lost their value at the height of the financial crisis in autumn 2008
 - Credit Suisse was held to have breached certain of the Conduct of Business Rules, which apply in the UK

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MIS-SELLING LITIGATION IN ENGLAND AND WALES (2)

Generally banks have been successful in the English Courts in defending mis-selling claims.

- *Rubenstein v. HSBC [2012] EWCA Civ 1184*

- Mr. Rubenstein, a retail customer, sought to invest the proceeds of the sale of his home with HSBC. In finalising the sale, the Bank reassured him in writing that the product he purchased was the same as "cash deposited in one of our accounts"
- The Court of Appeal held that it was the bank's duty to protect the investor from exposure to market forces when the investor had made clear that he wanted an investment which was without any risk

- *Taberna Europe CDO II Plc v. Selskabet (formerly Roskilde Bank A/S) (In bankruptcy)*
[2017] 2 W.L.R. 803

- The investor purchased from a third party (i.e. not the issuing bank) subordinated loan notes issued by the defendant bank, having seen an investor presentation on the defendant's website
- The Court of Appeal found that, in this case, an actionable representation had been made by the issuer, but that a disclaimer in the marketing document was sufficient to exclude the issuer's liability

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LOOKING FORWARD

The financial sector is becoming increasingly heavily regulated, meaning that those operating in these markets need to be aware of the developing regulatory landscape.

- EMIR
- MiFID II / MiFIR
- Consumer Legislation
- Senior Managers and Certification Regime
- Packaged Retail and Insurance Based Investment Products

(PRIIPS)

will require a

Key Information Document

(KID)

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79801-5-13249 0.1