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Hong Kong court rules in favour of bank in mis-selling claim brought by experienced investor

The Court of Appeal recently confirmed a bank's supervisory duties in managing a client's wealth and investments under a trust arrangement. Relieving provisions (i.e. "anti-Bartlett" provisions) do not always exclude the banks' core obligations to supervise and regularly monitor their clients' funds. Even if the clients are experienced investors, banks are not "liability-free rubber-stampers" of their clients' investment decisions.

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ZHANG HONG LI V DBS BANK (HONG KONG) LTD CACV138 & 139/2017, 27 JULY 2018 IS THE LATEST EPISODE IN INVESTOR LAWSUITS FLOWING FROM THE 2008 FINANCIAL CRISIS. At first instance, the claimant investors partially succeeded in their claims against the bank, based on its breach of trustee duties in monitoring their investments. But the investors lost in other claims against the bank and its employees for accessory liabilities for breach of trust. The Court of Appeal unanimously dismissed the appeals by the bank and the investors.

The case concerns a private trust for the benefit of a wealthy family. It was set up by an experienced investment banker and his wife, who was described by the Court as an "astute and experienced investor". The bank was the trustee. The wife had been appointed the investment advisor of the trust. From the start, the wife had been the decision maker in the trust's investments, which had enjoyed impressive initial successes. But as the global financial crisis unfolded in 2008, the trust suffered a net reduction of 70% of its NAV (Net Asset Valuation). The plaintiff investors commenced the action to try to recoup their losses, which was partially successful, against the bank and its employees.

Anti-Bartlett clauses

An interesting point of focus in the CA judgment is Cheung JA's discussion of the effect of anti-Bartlett clauses. These clauses are standard relieving provisions for a trustee, which derive their name from Brightman J's judgment in Bartlett v Barclays Bank Trust Co Ltd [1980] 1 Ch. 515. They are intended to have the dual effect of (1) allowing the trust to function without interference from the trustee; and (2) relieving the trustee from any such duty or power to intervene. In Hong Kong, such provisions have been considered as effective, for example by the Court of Appeal in Highmax Overseas Limited v Chau Kar Hon Quinton[2014] 3 HKLRD 584.

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The subject trust was governed by Jersey law. Cheung JA accepted that anti-Bartlett clauses are effective to exclude the obligations to which they refer. But the trustee has a "residual obligation", which these clauses do not exclude. These include "ensur(ing) that the value of the trust fund is subject to appropriate controls, reviews, investment expertise and management." Here, the bank trustee assumed a high level supervisory duty over the trust, including to approve investments with the power to override the wife's decisions, and to reverse the transaction she advised for the trust.

The Court of Appeal agreed with the trial judge that the bank had breached its duties as trustee, in approving (1) the trust's purchase of US$83 million worth of Australian dollars from 24 July to 5 August 2008; (2) the increase in the credit facility from US$58 million to US$100 million; and (3) the purchase of AUD/USD "decumulators", which effectively locked the trust's Australian dollar funds during the collapse of the Australian dollar and caused the expenditure of substantial breakage costs to "unlock" the funds. The judges found the bank trustee to be grossly negligent, and the degree of its breaches had been serious and flagrant.

Cheung JA also emphasised that "the high level supervision assumed by DBS Trustee clearly required it not simply to content itself with the receipt of information... (but) it ought to have gone one step further and made the inquiries... before giving approval for the impugned transactions."

It is notable that the bank's clients here were experienced investors. The Court described the wife as "a well-informed, proactive, knowledgeable, meticulous, assertive and aggressive investor. She was

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uninterested in low risk/low return investments... She ignored repeated warnings about the risks of over-concentration and refused to diversify Wise Lords' portfolio or to take a profit. Wise Lords' initial investment successes were impressive. The mutual funds generated an overall profit of more than HK$132.6 million, which could not have been made without the increases in credit facility..." Nevertheless, the Court of Appeal still ruled against the bank.

Proper scheme of banker-customer relationship

The case highlights the importance of structuring the banker-customer relationship properly at the outset, followed by diligent implementation of the scheme. Careful consideration should be given before setting up the investment structure, which should be recorded by proper documentation. Risk allocation and clear division of duties and roles between the bank and the customer will result in greater certainty, which can in turn avoid potential disputes and litigation.

A banker-customer relationship does not ordinarily give rise to a fiduciary relationship, which would oblige the bank to act in his best interests including to advise on the customer's investment decisions. Banks can usually rely on contractual documents to define the relationship as "execution only" rather than "advisory". There are exceptional circumstances in relation to certain "vulnerable" customers. For example, in Chang Pui Yin v Bank of Singapore CACV 194/2016, 20 July 2017, the Court of Appeal held that the bank cannot rely on non-reliance clauses to escape liabilities to two elderly customers.

Banks (and financial institutions) should pay special attention if the arrangement involves a trust, or there are circumstances which may result in a fiduciary relationship. In these cases, they may potentially have core obligations to advise on investments and to supervise their performance, irrespective of contractual terms.

In summary, in the private wealth management context:

1. Banks should carefully review the background, investment portfolio and risk appetite of individual customers, with a view to devising a suitable wealth management arrangement.

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2. The client agreement should set out the banker-customer relationship. If appropriate, the bank can define the relationship as "transaction execution only", as opposed to "advisory". Notably, paragraph 6.5 of the SFC's Code of Conduct for Persons Licensed by or Registered with the SFC prohibits any clause preventing a client's reliance on the bank's recommendation or advice.
3. Banks should assess their duties and powers in individual cases, especially in relation to high net-worth individuals. There are circumstances where banks are obliged to advise on and supervise investment performance, for example if the bank acts as trustee or if the customers are particularly inexperienced or "vulnerable".
4. In those cases, in order to fulfil their supervisory duties, banks should implement a scheme for the regular monitoring of the investments. These include procedures for the proposal and approval of investment decisions, regular review of the investment performance and frequent review of the customers' assets and wealth. ■