

UBS v KWL: The importance of being earnest

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A recent Court of Appeal case in the UK Courts has set an interesting precedent for how Courts will approach negligence claims against managers who appear to mis-sell their services to investors. In what is being described as a landmark decision, the Court of Appeal in *UBS AG (London Branch) v Kommunale Wasserwerke Leipzig [2017] EWCA Civ 1567* upheld Kommunale Wasserwerke Leipzig's (KWL), asserting in the alternative that UBS Global Asset Management's (UBS GAM) negligent management of financial derivatives sold to it by UBS AG, the primary defendant, caused KWL's investment portfolio to sustain a loss of US\$400m.

In coming to this conclusion, the Court of Appeal considered a number of factors and the analysis undertaken was quite complex. Amongst the analysis, we'd like to draw your attention to one point in particular - marketing materials.

Marketing Materials – An Extension of the Management Agreement?

Every fund manager wishes to sell its services and its expertise in a given field. No doubt many of this readership will have seen many, if not countless, pitch books, presentations, "red herring" documents, all proclaiming the weird and wonderful things the manager will do (or refrain from doing) with investments to provide returns to investors. Very often, we as legal advisers will have the job of reviewing scheme particulars, supplements, constitutional documents and management agreements to ensure all are compliant with law and regulation. But sometimes (and I suspect often), clients may not consider running their presentations and pitches by us.

Why does this matter? Turning back to *UBS v KWL*, the Court noted that, while the portfolio management agreement between UBS GAM and KWL was drafted in general terms, UBS GAM's "pitch book" was not. This pitch book was seen by investors (including KWL) and is, as far as the Court was concerned, an extension of the objectives and strategy set out in the portfolio management agreement. It contained UBS GAM's investment philosophy, which included a number of statements centred around identifying "problem credits" early, having an exit strategy for such problem credits, making substitutions to avoid defaults and adopting "no big bets". The Court of Appeal (agreeing with the judge in first instance) found that UBS GAM had failed to abide by these statements and had mismanaged the portfolio, as it had sought to improve the ratings of the financial derivatives in KWL's portfolio instead of making substitutions to avoid defaults, as it had stated it would.

In Conclusion

The case of *UBS v KWL* highlights the importance of discretionary asset managers being clear about their investment strategy, following through and doing what they say.

Simply put, if you market a strategy to an investor, be expected to follow it. If you need to change or adjust your strategy, make sure such a change is justifiable, and properly notified to your investors.

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It is also worth noting that the claim against UBS GAM was an alternative claim, the primary claim being one of fraud against UBS AG, resulting in the rescission of the US\$400m in financial derivatives sold to KWL.

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