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REVIEW

Professional Trustees: What does Louis Group mean for you?

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Professional Trustees: What does Louis Group mean for you?

It is settled law that Trustees have a duty to make sure that financial advice given to a trust is appropriate. There is a well-trodden trail of case law supporting a common law duty placed on trustees to act as would a prudent businessman when making investment decisions (starting with Speight v Gaunt (1883) 9 App Cas 1). For this reason it is appropriate, and even necessary, for trustees to make sure that they obtain advice and delegate that function to a qualified Independent Financial Advisor. The statutory obligation set down by sections 3 to 5 of the Trustee Act 2001 ("the Act") gives force to this common law duty, albeit the statutory requirements can be restricted or excluded by a trust deed.

In making decisions about investments, or in delegating powers in respect of such decisions, Trustees are required to act for the benefit of their beneficiaries. Regardless of the common law duty espoused above, this in itself can mean that Trustees are required to regularly review investments entered into to ensure that they remain appropriate. That is after all what a prudent businessman would likely do in dealing with his own affairs. Indeed this is a duty specifically placed on Trustees by the Act.

Clearly therefore, it is not enough for a Trustee to consider the job done, if for example an independent financial advisor is appointed and investments effected based on the advice given. There should be a regular assessment of whether the investments (and advisor for that matter) remain suitable. That itself will depend on the circumstances of the trust and/or beneficiaries. These can and do change. For example investment markets change, meaning that some funds which were considered suitable some years ago relative to risk appetite may no longer be so. The risk which it is appropriate for a beneficiary to take can also change. As people get older and acquire more commitments they generally become more risk averse. In addition the identity of the beneficiaries may change, warranting a rethink of investment decisions. Has the Trustee done the job of making sure the investment criteria changes with the trust where appropriate?

Suitability is more relevant now than it ever has been. The global downturn experienced over the past 5 years means that investments which were once considered safe are not necessarily so now. The Isle of Man has not escaped this trend, and in fact has its own unique set of circumstances relevant to the issue. Recent decisions of the Financial Services Ombudsman scheme (the Ombudsman) have highlighted advice given by IFA's to low risk investors such that they were encouraged to invest in Experienced Investor Funds (EIF's).

EIF's are a special class of fund for people who considered themselves to be sophisticated investors, well aware of certain inherent risks which particular funds presented. These funds did not benefit

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from the Isle of Man investor protection scheme (or any other investor protection scheme for that matter) and should only have been recommended where an investor had agreed in writing that they were to be considered experienced investors. On some occasions EIF's were sold by advisors outside the scope of the terms of the licence granted to them by the Financial Supervision Commission. In fact EIF's are generally accepted to be high risk funds (because they can lack transparency and/or trade in illiquid investments) and so are unlikely to satisfy the investment outlook of a great many trusts classified as requiring low or medium risk investments.

A well-publicised recent example of EIF fund risks is the Louis Group Secured Loan Note (and other Louis Group funds) which may have been sold on the basis of security and low risk. In fact, and as explained above, because it was an EIF it was likely anything but low risk and was certainly not capital secure. Last year the Ombudsman found on a number of occasions that Louis Group (and other) funds had been mis-sold, having been represented by advisors as low risk funds, akin to bank account savings. Furthermore, advisors had not explained the complex and unregulated nature of such funds.

The potential risk to professional trustees is clear. Having a duty to regularly review suitability means assessing whether any particular investment which was taken out remains appropriate. If a trust holds any EIF (such as a Louis Group fund), especially where the risk outlook for that particular trust was specified to be low (or even medium) risk, it is likely to be inappropriate. Trustees are compelled to take action to rectify the situation as soon as they become aware or should reasonably have reviewed the investments. If a loss has been occasioned then it may be possible to take legal action against any professional advisor. However action cannot be taken via the Ombudsman as that scheme is not available for Trustee investments.

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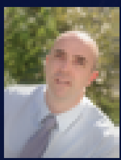

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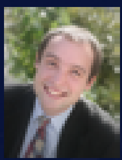

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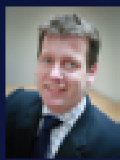

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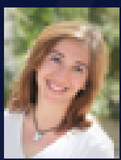

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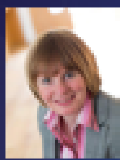

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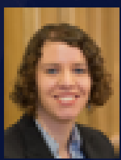

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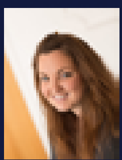

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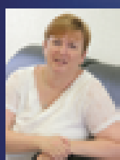

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