LEGAL ISSUES
FOR STRUCTURED FINANCE INVESTORS
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The David Doble Solicitors Publication for Investment Businesses

Complex Structured Investments – Caveat emptor!

A recent case in the English courts has passed very firmly to investors in structured note products the responsibility to review for themselves all relevant legal documentation. The court said that investors should be bound by the terms of the final (i.e. executed) contract documentation even where those documents contradicted the transaction termsheet previously reviewed by the investor.

Indeed, the court went further and inferred that the arranging bank would have no positive duty to draw attention to the fact that a material change had been made to the transaction between the stages of termsheet and final documents.

The case (Peekay Intermark Limited v Australia and New Zealand Banking Group Limited) involved a claim by an investor in respect of a structured Note sold to it by ANZ Bank Group in 1998. The investor was originally informed that the Note would carry some kind of proprietary right in a specified amount of Russian GKOs (Russian Government Bonds) and the indicative term sheet confirmed this. Subsequently, the transaction structure was changed so that the principal of the Note was linked to the performance of the GKOs. This change was not specifically brought to the attention of the investor. When the GKOs became subject to a Russian Government moratorium later in 1998, the Notes redeemed at a tiny proportion of their face value. The investor claimed that ANZ had misrepresented an essential feature of the transaction and that, had the Note actually been secured on GKOs as originally stated to it, then the recovery would have been much higher.

> "The investor claimed that ANZ had misrepresented an essential feature of the transaction"

Initially, the lower courts in the UK passed judgment in favour of the investor. However, in April 2006, the Court of Appeal reversed this decision and found against the investor. It has been reported that the investor does not intend to appeal and, accordingly, for the time being, the judgment of the Court of Appeal must be considered to be settled law.

The judgment is an important one for institutions investing in structured products that are governed by English law. It is now incumbent on those institutions to ensure not only that they have read and understood the termsheet but also that they have read the final contract documents to ensure that they reflect the termsheet.

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Comment

Interagency Statement on Sound Practices Concerning Elevated Risk Complex Structured Finance Activities

On 16 May, 2006, five US regulatory agencies, including the Federal Reserve and the Securities and Exchange Commission issued a revised version of a statement on sound practices concerning elevated risk complex structured finance activities (the "Statement"). The original version (issued in 2004) had drawn much comment and criticism from the financial services industry in the US and beyond.

The revised version of the Statement attempts to set out some guidelines for financial institutions entering into "elevated risk" "complex structured finance activities". Neither of these terms is specifically defined. However, the revised Statement appears to identify one such type of activity as those "designed or used to shield their customers' true financial health from the public".

Interestingly, neither the revised Statement nor any of the published responses to it, have identified the issue mis-selling of complex structured finance instruments as one that "may pose heightened levels of legal or reputational risk to the relevant institution" (these words are used to give a general description to the term "elevated risk CSFTs"). Nevertheless, at least in the European market, the allegation of mis-selling is among the most common type of complaint made by institutional investors in complex structured finance products.

It seems to us that the issue of highlighting and explaining the increasingly complex risks inherent in many of the structured instruments on offer in the international markets today should be a matter of equal concern to regulators in the US and indeed beyond.

ISDA Derivatives Users Committee

The ISDA Derivatives Users Committee had its inaugural meeting in Spring 2006. The mission of the committee is to provide a forum for non-dealer firms, represented by the ISDA subscriber membership category that are active in privately negotiated derivatives as clients, investment managers or managed funds. It will also discuss OTC derivatives operations processing, documentation, risk management and market practices, providing a buy-side voice to ISDA initiatives in automation and straight through processing, and helping the further development of the OTC derivatives market through education and training.

The Derivatives Users Committee will be a means to provide input and stay updated on the work done in various other groups and to identify and deal with user-specific issues where appropriate. Projects identified at the first meeting and in subsequent meetings include the use and best practices around Master Confirmations and Settlement Matrix and Calculation Agent and Dispute Resolution Language.

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ABOUT DAVID DOBLE SOLICITORS

Legal advisory to institutional investors...

David Doble Solicitors was established in London in 2005 to provide legal advice to institutions, within Europe and beyond, investing in complex structured financial instruments.

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