

# Information about early repayment of a convertible bond

Topic: **Stock exchange and custody accounts** Case number: **2018/14**

An asset manager claimed on behalf of a number of his clients that the bank had not issued information regarding the termination of a convertible bond even though, as custodian bank, this was one of its obligations. For this reason, he had not exercised the conversion rights for his clients prior to the repayment. This would have been much more lucrative for them because of changes in the price of the shares these bonds could have been converted to than the amount received from the early repayment. He claimed the corresponding compensation from the bank. The bank was not willing to satisfy the customers' claims. The bank confirmed its position during the Ombudsman proceedings.

When checking the transaction receipts for client custody accounts, the asset manager noticed that an issuer had repaid a convertible bond early. He and his clients had not been notified about the early repayment by the custody bank in question. Because of favourable share price changes, it would have been much more lucrative for his clients to exercise the conversion right than to wait for the early repayment. He blamed the bank for the fact that he had missed the opportunity to exercise such rights due to the lack of information. He asked the bank to compensate his clients for the difference between the value of the shares they would have received upon conversion, and the much lower repayment sum. He pointed out that other banks with which he also held client custody accounts, had provided notice of the early repayment. The bank rejected this claim for compensation and claimed that it had not received any information about the repayment itself from its custodian. Moreover, the asset manager had knowledge of the repayment from another source and was therefore able to exercise the conversion right for his clients in good time.

The asset manager disagreed with this position and submitted a request for mediation to the Ombudsman. He stated that the convertible bond could be terminated by the issuer in full or even only partially. In this respect, he was reliant on the custody bank telling him whether or not the securities held by it were affected by the early repayment. He also believed that, in this particular situation, the bank was under an obligation to exercise the conversion rights to safeguard the customers' interests.

The Ombudsman asked the bank for its views on the customer's case and reasoning. Only after a reminder, the bank essentially repeated to the Ombudsman what it had already said to the asset manager in response to his claim for compensation without going into detail on any of the arguments put forward. After a further intervention and reminder, the bank eventually stated its full views on the matter. It explained that it had received notice from its custodian regarding the early repayment of the convertible bond. This was a so-called "mandatory corporate action" in which the clients would not have had any individual opportunity for choice and so the bank also did not have to obtain any instructions from them. The latter were entitled to exercise the conversion rights at any time under the terms and conditions stated in the bond prospectus. In accordance with its custody account regulations, the bank does not provide notice of such "mandatory corporate action". There was no other legal basis for this obligation to provide information either. Finally, in the case of "execution only" customers, the bank's only obligation was to act in a manner that protects their interests. The bank reiterated that the asset manager had knowledge of the early repayment from another source

and that, if there were any uncertainty as to whether or not the securities held with the bank would be affected by the early repayment, he should have enquired accordingly. It was solely for him to exercise the conversion right for his clients. The bank even went so far as to accuse the asset manager of acting in bad faith.

Since the bank was clearly not willing to accommodate the claims of the asset manager's clients, the Ombudsman had no choice but to close the case unsuccessfully. In his concluding notice sent to the asset manager, he stated that a contractual obligation to provide compensation was a matter for discussion in this case. Such a claim arises where an injured party suffers damage or loss due to the breach of a contractual obligation by the contracting partner with a so-called sufficient causal connection, and where said breach is attributable to the contracting partner. The injured party also has a duty to minimise or mitigate the loss or damage. The latter must therefore ensure that any resulting damage or loss is kept to a minimum.

The Ombudsman agreed with the bank that the scope of the information to be provided to the customers was primarily based on the custody account agreement. This was however not as clearly worded on the matter at hand as the bank claimed. Various other banks had also decided differently in this specific matter and had notified their customers about the early repayment. On the other hand, whether or not the lack of information from the bank was the cause of the damage or loss incurred was in fact doubtful here given that the asset manager had knowledge of the early repayment of the convertible loan from other sources. Also, the argument that the asset manager could have inquired whether or not the specific securities held with the bank would be affected by the early termination as part of his obligation to minimise or mitigate the loss or damage, seems viable. Ultimately, it was clear from the custody account agreement that the bank was not obliged to act in a manner that safeguarded these interests. After closing the case without reaching a resolution, the Ombudsman advised the asset manager and his clients to consider the arguments presented by both sides carefully when deciding whether to pursue the claims for compensation and, if necessary, to seek legal advice.