Loss with a Barrier Reverse Convertible

Topic: **Stock exchange / securities account** Case number: **2020/26**

> The customer purchased a so-called barrier reverse convertible on various shares, including those of Wirecard, via his bank. The purchase took place without advice, i.e. “execution only”. After Wirecard’s share price completely collapsed due to the fraud scandal, the client suffered a high loss. He severely reproached the issuer of the barrier reverse convertible and wanted to reverse the transaction on the ground of fundamental error. When he could not reach an agreement with the issuer, he submitted the case to the Ombudsman. The Ombudsman was unable to help the client as he did not see any wrongdoing on the part of the issuer. The Ombudsman closed the case with a notice to the client.

The issuer of a barrier reverse convertible on shares usually promises to pay investors a periodic premium, a so-called coupon, during the term of such a structured product. If none of the shares on which the product is based falls below a predefined limit (called the barrier) during the term, the investors are also paid back the invested capital. However, if a share touches the barrier, the investors are allocated a fixed number of those underlying shares which incurred the worst price development.

In the Ombudsman’s experience, investors often confuse the coupon with an interest payment and, in today’s interest rate environment, are tempted by the regularly high coupons to invest in barrier reverse convertibles. In fact, they bear an equity risk that can lead to the total loss of the capital invested if one of the shares on which the structured product was issued becomes worthless. Investors are compensated for this risk with the coupon, which represents rather a risk premium than an interest payment. Wirecard shares were popular for issuers of barrier reverse convertibles. Thus, several such products based on this share were on the market. Its volatility allowed issuers to offer a high coupon. In this case, the coupon was almost 20%.

The customer thus benefited from the high coupon, but had to accept a total loss of the capital invested, as the Wirecard shares not only touched the barrier during the term, but even became completely worthless and instead of the capital repayment, he was allocated the shares with the worst price performance after the product expired. He then severely reproached the issuer and described it as an accomplice in the so-called Wirecard fraud case. He wanted to reverse the transaction on the basis of a fundamental error or, alternatively, demanded damages due to a lack of risk disclosure or “culpa in contrahendo”. Finally, he referred to the prospectus liability under the new Financial Services Act FinSA.

It was undisputed that the issuer was aware of the allegations of fraud against Wirecard, which journalists from the Financial Times had been the first to raise, which however had not been perceived as a cause for concern in the market for a long time. It was thus in good company with other issuers as well as with Wirecard’s auditor, the stock exchange, the supervisory authorities and other responsible bodies. The Ombudsman expects that the investigation of the fraud scandal surrounding Wirecard will continue for a long time and that a lot will come to light in the process.

The issuer was of the opinion that these issues had been publicly known. In its view, it was not

possible to invoke the legal argument of fundamental error because the barrier reverse convertible was clearly a speculative product. Moreover, it did not distribute its products to private persons and was neither responsible for the advice nor for the risk disclosure. In its opinion, this was the responsibility of the bank at which the client had purchased the product. A legal claim based on “culpa in contrahendo”, a pre-contractual liability that is linked to special conditions, was in the issuer’s view out of the question because the client had not conducted any contractual negotiations with the issuer.

In this case, the Ombudsman exceptionally had to detach himself somewhat from the specific arguments of the parties, which in his view missed the core issues on both sides. According to the Ombudsman’s understanding, the issuer had fulfilled its undoubtedly existing risk disclosure and information duties in the present case with a simplified prospectus. The provisions of the FinSA on the obligation to publish a prospectus were not yet in force at the time of the issuance and did not apply. In the Ombudsman’s view, the prospectus for the product in question provided adequate information about the main risks. This included the fact that the investor had to expect and accept that, instead of being repaid his capital, he might be allocated the share with the worst price performance. In addition, the issuer had to describe the underlying shares and provide the data necessary for their identification as well as the relevant stock exchange. The Ombudsman was not aware of any further obligations of the issuer in relation to the underlying shares. There is regularly no analysis of the shares in such a prospectus. In the Ombudsman’s view, it is up to the investor or, where appropriate, his investment adviser or asset manager to form an opinion about the underlying shares on the basis of the publicly available information. As it was undisputed that the client had not received any investment advice or asset management services from his bank in the present case, it would have been up to him to do so himself.

Finally, the Ombudsman found it comprehensible that the issuer assumed that the information subsequently relied on by the customer in relation to the Wirecard fraud was public knowledge. There were no indications that the issuer should , on the basis of information that was not publicly known, have weighted this differently than other market participants or the responsible bodies mentioned had done. The Ombudsman did not consider the conditions for a fundamental error or for a pre-contractual liability to be met. Although he could understand the client’s disappointment about the loss, he had to inform him in a final notice that he considered a mediation procedure to be futile.