Losses in connection with an asset management mandate with a high bond component

Topic: **Asset management** Case number: **2023/18**

> The client's daughter complained to the Ombudsman about losses that her elderly mother had suffered with an asset management mandate with the investment objective "income" in 2022. The losses were primarily due to the high proportion of bonds in the mandate, as bonds fell in price in 2022 due to the rapid rise in interest rates. She did not consider the conclusion of such a mandate in 2021 to have been sensible in principle, as the acquisition of bonds with an interest rate of 0% could only result in losses in the long term. The bank rejected the claim for damages and argued that the investment objective was in line with the carefully established client profile. The client had been sufficiently informed of the risks associated with the mandate. The Bank was also not prepared to make concessions in the Ombudsman proceedings.

In addition to her main allegations, the client's daughter claimed that her mother had in the past only invested in fixed-term deposits and had no experience of investing in bonds. In view of the interest rate situation in 2021, the money would have been better left in a savings account, which would also have paid low interest, but at least would not have been associated with a price risk. The so-called duration of the bonds in the mandate of 7 years and the investment horizon of 5 years was also not reasonable in view of her mother's advanced age.

The bank explained that the client had very well experience with both equities and bonds. She had approached the bank because she wanted to continue holding securities investments, but no longer wanted to look after them herself. For this reason, she was recommended an asset management mandate. In view of the client's low risk tolerance, the investment objective "income" was chosen. Such a mandate is based on a standardized asset allocation (5% liquidity, 60% bonds, 25% equities and 10% alternative investments). She had been informed about this and the associated risks by means of the "Risk disclosure" brochure and by means of specific calculation examples. She had agreed to this and also expressly selected an investment horizon of 5 years.

In response to the argument that an investment in a 0% investment could only result in losses in the long term, the bank replied that an investment in bonds with low or even 0% interest rates corresponded to a conservative investment strategy at the time. Account balances did not earn better or even negative interest at that time. The client had also expressly requested securities investments. It was also unclear whether there might be further interest rate cuts. This would have resulted in appreciation or price gains on bonds. As part of a general adjustment to the investment strategy, which is continuously reviewed, the bond component has been reduced to around 50% due to the possibility of an interest rate increase. However, the sharp rise in interest rates following the pandemic was not foreseeable and took market participants by surprise.

In the reporting year, several cases were submitted to the Ombudsman in which clients complained about losses in connection with bonds. This related to both asset management mandates with a strong focus on bonds and corresponding investment funds acquired as part of investment advisory mandates. Compared to shares, such investments are traditionally considered low-risk and conservative because they are less subject to price fluctuations. However, this was not the case in

2022, when practically all asset classes performed negatively. Bonds were even particularly affected by price losses due to the rapid rise in interest rates. Although this development was only one of the possible scenarios at the time of the consultation, the interest rate risk should at least be addressed as part of a comprehensive discussion of the opportunities and risks, taking into account the client's desired investment horizon in view of the long-lasting, historically low interest rate level. According to the Ombudsman's perception, it was also common market practice at the time under discussion to treat bonds as conservative investment instruments.

In the case of investments made as part of an asset management mandate, the market risk generally lies with the investor. There is no guarantee that estimates about the future development of markets and prices will prove to be correct. Within the framework of an asset management mandate, the banks have considerable leeway in implementing the investment objective. They owe a careful implementation of the mandate, but not a specific investment performance. The mere fact that a loss has occurred therefore does not mean that the bank acted carelessly and is liable for it.

A mandate may be deemed to have been exercised improperly if, among other things, the decision or recommendation to make a certain investment or to structure a portfolio in a certain way was obviously unreasonable at the time or contradicted specific contractual agreements or the investor profile.

The Federal Supreme Court then assumes that the agent has a comprehensive duty to inform, advise and warn in asset management mandates, depending on the client's level of knowledge and the type of investment opportunity in question. According to one of its rulings, handing out a risk disclosure brochure to a client who is completely inexperienced in investment matters does not constitute sufficient risk disclosure.

In the case of the client in question, the dispute centered on the question of whether it was reasonable and justifiable in spring 2021 to invest a large part of the assets in bonds or bond-type products that move in the same direction when interest rates change, and whether this was in line with prudent investment activity. The question also arose as to whether the client had been informed about the peculiarities of this investment allocation in such a way that she recognized its implications. It should be noted that investments were made primarily in bond funds. Whereas an investor in individual bonds can wait for repayment of the investment in the event of a book loss due to rising interest rates and then receive the nominal capital, the situation with a bond fund is more difficult to explain , so that an investor is more likely to be worried if the fund falls in value and may sell it at the wrong time. The book loss only becomes a realized loss upon sale. Investors are well advised not to take such a step hastily. They will then no longer be able to benefit from possible price recoveries.

The bank refused to make concessions and explained in its statements to the Ombudsman why it had rejected the alternative of leaving the capital invested in the bonds in savings accounts. This would have eliminated the asset management fees, but negative interest would have been incurred, depending on the circumstances. It argued that the interest rate trend was uncertain at the time and that the sharp increase could not have been foreseen. It had acted carefully in the asset allocation and the client had been informed about the interest rate risk with calculation examples.

The Ombudsman is dependent on the willingness of the parties to make concessions in order to reach an amicable settlement. The bank firmly rejected this on the basis of its arguments, so that the Ombudsman discontinued the mediation efforts and closed the file with an explanatory letter.