# Using Experts in Investment Litigation

*"It's only when the tide goes out that you learn who's been swimming without a bathing suit."* – Warren Buffett

Investment losses are often followed by lawsuits and requests for expert advice on investment performance have formed one of GBRW Expert Witness's most active areas of work since 2008/2009.

This briefing paper comments on a number of issues which we believe investors, trustees, investment advisers and investment managers will find helpful if they are contemplating, or defending against, litigation.

## Potential grounds for claims

Each case will have its own characteristics, but in our experience the following elements feature regularly:

- A mismatch to the investor's requirements. In a falling market, many complaints will be based on the assertion that the investor's risk appetite was either misunderstood, incorrectly recorded or ignored.
- The characteristics of the investment. The investment adviser or manager may have mis-classified or misunderstood the nature of the investment, which may in turn imply failures in its product approval process and/or its underlying due diligence or analysis.
- Unprofessional behaviour, typically exhibited in practices such as mis-selling to inexperienced investors or misrepresentation of the nature of the investment product.
- Fraud. In its most blatant form, this may involve theft of assets or Ponzi schemes such as Madoff's. Less extreme forms may involve churning, self-dealing and front running.

In many cases, these practices may be symptomatic of inadequate governance and control processes in the investment manager or adviser. There may be a number of headings under which claims for compensation can be pursued.

## Typical areas addressed

It is important to bear in mind that poor performance is not automatically a basis for a claim. The starting points for expert advice will usually include the following areas:

- Were the investments appropriate? Under this heading, the expert will examine the investor's risk appetite and stated investment objectives, the nature of the investments which are the subject of the litigation and the percentage of the total portfolio which they constituted.
- Were proper procedures followed? Many jurisdictions have detailed requirements for fact-finding and record-keeping procedures when advisers are dealing with clients. Investment advisers and managers will also have internal policies and procedures which they may have to disclose in litigation. Failures in either of these areas may not

necessarily establish the basis for a successful claim, but they will often be relevant to the claim and may generate pressure for a settlement.

- Timing. Certain classes of investment (split caps, for example) become increasingly risky as the original concept is developed. The point at which advice was given can often be crucial and access to industry data and comment at different points in time may be necessary to substantiate claims.
- Quantum of loss. Even when it can be established that a particular investment was mismanaged, "what if" analyses for a number of scenarios are required to establish the loss for which the investor can actually claim. This loss will be set by reference to the position he or she would have been in if the investment had not taken place.

Expert advice will often also be required to assist in analysing the risk elements of structured investments. Examples in recent years involve securitisation vehicles which "slice and dice" risk into different tranches, bonds where the investor has (often unknowingly) written an embedded option for the benefit of a third party and guaranteed return investments which depended on credit support from a financial institution which lost investment grade credit rating or even collapsed.

## For further information

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