MAYER·BROWN

Legal Update
October 2016

Financial advisers' duty of reasonable skill and care: ensure the investor is aware of any material risks

Summary

When providing financial advice, the adviser is under a duty to exercise reasonable skill and care. The High Court in *O'Hare and O'Hare v Coutts & Co* [2016] EWHC 2224 (QB) held the relevant test is that laid down by the Supreme Court in *Montgomery v Lanarkshire Health Board*: whether the adviser made the investor aware of any material risks involved in any recommended investment, and of any reasonable alternatives.

The judge in *O'Hare* held that the *Bolam* test which had been the previous benchmark as to whether or not the defendant had exercised reasonable skill and care (i.e., whether the adviser was acting in accordance with a "practice accepted as proper by a responsible body of men skilled in that particular art") no longer applied, and the applicable test was that set out in *Montgomery*. The judge in *O'Hare* was at least in part swayed by the fact that the expert evidence indicated there is little consensus in the financial services industry about how the treatment of risk appetite should be managed by an adviser.

Facts

Mr and Mrs O'Hare entered into a contract with Coutts whereby Coutts would provide them with its advice and recommendations in writing to develop an investment strategy for them and to advise them on potentially suitable investments. Coutts could recommend both its own products and those of third parties. Pursuant to that contract, in 2007/8 the O'Hares invested a total of £8.125 million in various products which Coutts recommended (the **"2007/8 investments"**); and in 2010 they invested a total of £10 million in various products (the **"2010 investments"**), which again Coutts recommended. Due to the economic turmoil in 2008 the 2007/8 investments lost value. In relation to the 2010 investments, the O'Hares felt that these were underperforming and redeemed them early, which thereby caused them loss.

The O'Hares argued that the 2007/8 investments and the 2010 investments were unsuitable, and that they were not sophisticated investors – in effect, that the investments had been mis-sold. Coutts argued that the investments were suitable and the O'Hares were sophisticated investors who had been fully informed of the risks. The O'Hares alleged breach of contract, breach of statutory duty (the Conduct Of Business Sourcebook (**"COBS"**)) and negligent misrepresentation; they claimed just under £3.3 million plus interest. Coutts denied all the allegations.

Mr Justice Kerr found in favour of Coutts on all counts. Whilst the judgment is interesting for many reasons, including Kerr J's approach to hearsay evidence (one of the investment advisers from Coutts was not called or summonsed as a witness so his contemporaneous notes were submitted as hearsay evidence), the focus of this note is on the test the court applied when determining whether Coutts (by its investment advisers) breached its contractual and tortious duty of reasonable skill and care.

The duty of reasonable skill and care – the *Bolam* test

The test of whether a professional had been negligent was set in the medical professional negligence case of *Bolam v Friern Hospital Management Committee* [1957] 2 All ER 118. Mr Justice McNair held that the question is whether the professional, acting in the way he or she did, was acting "in accordance with a practice accepted as proper by a responsible body of … men skilled in that particular art". As Kerr J noted, "in the financial context, this is often paraphrased by saying that the recommended investment must be 'suitable'."

Both the O'Hares and Coutts put forward expert reports on whether the recommended investments had been suitable. However Kerr J noted that the reports "did not reassure [him] that there is a clear consensus within private banking and [the] financial services industry about the boundaries that delimit the proper role of a financial adviser".

The duty of reasonable skill and care – the new *Montgomery* test

Kerr J noted that the test for explaining risks to a patient in a medical context has recently been held no longer to be governed by the *Bolam* test. In *Montgomery v Lanarkshire Health Board* [2015] UKSC 11 the Supreme Court held that the duty of reasonable skill and care when informing a patient of the risks is normally "to take reasonable care to ensure that the patient is aware of any material risks involved in any recommended treatment, and of any reasonable alternative or variant treatments."

The test of whether a risk is material is "whether, in the circumstances of a particular case, a reasonable person in the patient's position would be likely to attach significance to the risk, or the doctor is or should be aware that the particular patient would be likely to attach significance to it."

Kerr J held that in the context of investment advice there must be proper dialogue and communications between adviser and customer "to ensure the client understands the advice and the risks attendant on a recommended investment". However, the test for the financial adviser to satisfy is not the *Bolam* test but the *Montgomery* test: i.e., whether the adviser had taken reasonable care to ensure that the customer was aware of any material risks involved in any investment, and of any alternative or variant investment.

On the facts before him Kerr J found that the "fullness of the information" the O'Hares had been given in relation to the investments "meant it was impossible to complain that the products were mis-sold". By being able to evidence that the O'Hares had been fully informed about the risks of the recommended investments, Coutts (by their financial advisers) had not breached the *Montgomery* test and had acted with reasonable skill and care.

Comment

The preference for the *Montgomery* test over the *Bolam* test in the context of providing financial advice to individuals gives greater certainty to banks and financial institutions as to what is required of them: to ensure that the customer is made aware of any material risks, rather than trying to comply with an inchoate body of opinion as to what a financial adviser should do (which, as Kerr J found, is often difficult to ascertain even with the benefit of hindsight and expert evidence).

In short, this is a welcome affirmation that "caveat emptor" still applies to investors, provided they are made aware of any material risks.

If you have any questions or require specific advice on any matter discussed in this update, please contact:

Ruth Malone
Of Counsel, London
rmalone@mayerbrown.com
+44 20 3130 3207

Chris Roberts
Senior Associate, London
croberts@mayerbrown.com
+44 20 3130 3543