



Flat A
4 Candover Street
London W1W 7DJ
0207 323 9171
07900 248150

E: adamsamuel@aol.com
W: www.adamsamuel.com

News

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Dear Friends



2008 lived under the shadow of impending financial gloom. I started the year ready for the storm ahead. I had survived a

very unpleasant down-draught in 2002 but only just. However, while the entire financial system was melting down, I found myself... doing quite well and the second half of the year was very busy indeed.

There was nothing obvious to explain my annual growth of over 20% from 2007's record turnover and profit figures. So, it could all unravel in a hurry. I am all too well aware that 2008/2009 could bring and has already brought hard times to good people who do not deserve it.

While increasingly, any consulting business operates through memory sticks and wi-fi from almost anywhere, 2008 has taken me to some improbable places. Belfast, Geneva, Glasgow, Hong Kong and even Paignton (in South Devon) have all seen me doing my thing. Curiously, on both the financial services regulatory and dispute resolution work, I have done things for prestigious organizations abroad that suit my abilities far better than most and for which nobody in the UK has thought of using me.

It is always good to see clients benefiting from following advice. I saw a fun example in 2008. A few years ago, a company contacted me looking for advice on how to develop their business. I suggested a three-half-day course using their past work. At some point during it, they reckon, I said something which changed their approach to a particular issue. They keep a database entry for the amount of money it has earned their clients. It topped £2 million this year. It was all because, unlike their competitors who occasionally use me, they were prepared to allow the consultant to advise.

On a lighter note, I continue to hold excellent business meetings in a variety of unusual London locations. My local Scandinavian Kitchen in Great Titchfield Street is both delightfully friendly and a good source of nosh, coffee and improbable contacts. The downstairs café at the British Library and the Place Below vegetarian restaurant in Bow Church, Cheapside have such fantastic echoes that one can plot the revolution in total privacy. The food at the latter is also worth taking seriously in its own right.



The group of us that sing regularly at the Golden Eagle pub in Marylebone Lane continue to welcome with much enjoyment guests from around the world, usually preceded by excellent fish and chips at London's best, the Golden Hind. Come and join us. Restaurant of the year, though, was Fabrizio in St Cross Street, near Hatton Gardens, London's diamond district and its mind-blowing chocolate mousse.

The financial meltdown & the associated fall-out

In a financially sophisticated world, know your product has become almost as important as know your customer. The banks seem to have failed to apply this to themselves.

Commentators are still arguing about the causes of the 1929 Wall Street crash. So, it is unlikely that the full story of last year's mayhem will be available for a few years. While over-lending is a common cause of banking disasters, the 2008 version appears to have been caused more by banks holding assets that suddenly dropped in value and lost liquidity when the market for mortgage-backed securities died. This probably coincided with an economic cycle headed naturally towards a recession.



The curious feature of this was the way in which the source of the banks' problem seems to have been the same as that of much bad advice given in recent years by financial institutions to their customers. For some years, I have been concerned that customers have been recommended investments in things that they do not understand and of which sometimes their advisers only have a modest grasp. In a financially sophisticated world, "know your product has become almost as important as know your customer". The banks seem to have failed to apply this to themselves. In different parts of the world, the failure of Lehmans has set off retail misselling scandals of various structured products.

This raises the important issue of the extent to which a customer needs to be able to understand an investment to be recommended it. Here, MiFID (the Markets in Financial Instruments Directive) makes it clear that customers must be able to understand the investments they are recommended. Regulators' talk of "informed consent". Purchasers should be able to appreciate the general nature of the risks that they are accepting. This is obviously a vague requirement but there cannot be any serious excuse for advising non-professional investors to buy collective investments that depend on derivatives to deliver the headline promised return. Recent discussions about hedge funds have centred around the extraordinarily

well-named Mr Madoff. Some surprising organizations, notably charities, seem to have lost fortunes with this individual's fund. Several charities should be seriously considering suing the fund managers who put their money into Madoff not because of that individual's fraud but because the use of hedge and similar funds for charities is inappropriate. They are essentially a collection of non-asset based gambles. The Charity Commissioners might also like to take an interest.

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Inevitably, tough times bring financial scandals to the fore. A harmless inappropriate investment can become a disaster. I did an interview for BBC's Money Box on the AIG premium access bond, the enhanced fund of which was closed to redemptions for three months by the insurer as it emerged that this "cautious" fund was not quite as safe as presented by the insurer and some of the firms that recommended it. The Cairn Report found that over one-sixth of the fund was invested in sub-prime mortgage-backed securities. As this was a product being sold as a bank account equivalent, the news must have come as a shock to all concerned. Many investors have put huge sums of money into this product without being told what was in it and the risks involved. One hopes that the FSA steps in and brokers a deal between the advisors, insurer and customers involved to prevent litigation in the coming years. As part of my work in this area, I have seen documentary evidence of advisers

The financial meltdown & the associated fall-out continued.....

giving wildly inaccurate assurances of total safety and comparisons with bank and building society accounts. This raises doubts about the structural soundness of some extremely well-known institutions.

Recent events have raised questions about the appropriateness of packaging or engineering assets. Securitization is vital to enable assets to be moved around. It does not create the problem as such. Everyone concerned, though, needs to understand the components of the assets being sold along with the risks involved relating to pricing, interest rates, defaults, liquidity and the like.

Financial Services Compliance



With the main UK financial institutions crashing as if they were at a demolition derby, it has inevitably been an odd year for compliance. The most obvious message for the UK Financial Services Authority (FSA) is that its previous models for measuring business risk do not work. In the early part of the year, the regulator's internal audit report on the risk-rating of the failed Northern Rock bank made startling reading. To put it simply, the auditors could not work out why an institution with an unusual business model dependent on the securitised mortgage market, was the only one of the UK's major banks to receive the lowest possible ARROW or risk rating. They could not find any explanation given.

Risk-based regulation and its kindred spirit, "risk-based capital", lay exposed in 2008 as a myth. The problem with capital is that essentially it does not exist at precisely the



moment when it is most needed. A downturn in a business or a liquidity crisis almost by definition reduces the company's regulatory capital. The model is broken. It is vital that the FSA stops using the crutches of capital adequacy and risk assessments as an excuse for proper regulation of the asset mix and liquidity of major institutions.

Against this background, the FSA announced in November that it would be closing down its Treating Customers Fairly initiative and moving its monitoring activities of large firms on this subject into... their ARROW risk assessments! Treating Customers Fairly has proved the catalyst for some improvements in a number of areas, notably financial promotions and unfair contract terms. However, much remains untouched.

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The regulator seems curiously blind to the need to encourage providers to draft insurance or investment contracts in language customers will understand. Instead of focusing on this and the need to improve advice standards, the FSA's Treating Customers Fairly work has become more obscure in the last few years, resulting in arcane pronouncements on corporate culture and management information of doubtful validity.

Two areas where I have been active in the last year have dominated the headlines lately: payment protection insurance (PPI) complaint handling and financial advice standards. The Financial Ombudsman Service has implored the FSA to take action on PPI to avoid a deluge of cases landing on its doorstep. About 20,000 arrived in the last year.

The second area is that perennial: financial advice standards. An ominous if strangely incoherent "Letter" that the Financial Services Authority issued to firms in December warned of terrible things if firms did not review their past advice to customers to switch from one pension product to another. The Letter also raised concerns about income drawdown, a product rarely well-recommended in my experience. My complaints book, still selling almost four years after publication, contains warnings

on both these subjects (at pages 141 and 156-164 & 391-392).

The more general issue of advice standards was the subject of two public workshops I did this summer that are being repeated this year. Both clients and products are becoming increasingly sophisticated. The result is that the traditional regulatory model of how advice is given essentially does not work. Advisers need to build up a detailed picture of their clients, their attitude to different types of risk in a variety of situations and their future plans and objectives. They must then give separate advice to cover the various issues to which these features give rise. A fact-find followed by a product recommendation is increasingly seen as creating unacceptable risks to both client and adviser.

Two things on the horizon are the FSA's development of a Banking

Conduct of Business Sourcebook (BCOBS) essentially to replace the current voluntary Banking Code and as predicted in last year's newsletter a redraft of MCOB (Mortgage Conduct of Business).

These are two areas where I have been doing work in the last year. There are concerns that the FSA will throw out some of the good features of the banking Code in trying to make it more principles-based. MCOB reform should hopefully deliver a shorter more coherent rulebook.

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Dispute Resolution

In 2008, I continued to act as an arbitrator or adjudicator while teaching and writing about dispute resolution in its various forms.

I resolved a string of domain name disputes as part of my work for the World Intellectual Property Organization panel on the subject. The decisions can be found on the www.wipo.int. The judicial nature of that activity prevents me from saying too much but I cannot resist mentioning one case that made me smile. The lawyer for a well-known boxer filed a complaint asserting Common



Law trademark rights for his client's name without actually saying or providing evidence that his customer was the boxer in question. He was very offended when asked for it. Almost everyone I have spoken to in the legal world had no idea who the gentleman was. So, it was just as well that WIPO appointed a sports fanatic to decide the case.



It was lovely to meet old friends again at the WIPO panellists meeting in Geneva in October. The Hong Kong International Arbitration Centre appointed me to do another extremely awkward domain name case, the result of which appears on its website. It also provided me twice with very pleasant hospitality during the year.

I continue to serve on the Chartered Institute of Arbitrators, Practice and Standards Committee and Arbitration Sub-Committee. On the former, I became involved in an interesting discussion about the resources of the Institute as a learned society. The key point about this is that with membership around the world, our resource is essentially the sum of the members' knowledge. This was hammered home to

me when an academic in Queensland e-mailed me in search of an English translation of a Swiss judgement. A few e-mails later, up popped a copy from the delightful Professor Loukas Mistelis at QMW in London.

One of the joys of the international arbitration community is its provision to me of a delightful worldwide social network. The Institute Committees I sit on have members in Continental Europe, Asia Pacific, Australia and the US. On a trip to Paris, I was able to meet a lawyer, I last saw in the late 1980s and introduce him over lunch to another old friend. I even finally met a distinguished lawyer there, over 25 years after I shared a house with her younger sister (and eight others!) in Oxford. Two trips to Hong Kong and one to Australia have given me the opportunity to break bread of varying types with good friends there. I even made it into a University classroom, teaching the arbitration session of the honours international trade course at Strathclyde in Glasgow. I did this for

Jenny Hamilton with whom I managed the unusual hattrick of eating meals in London, Glasgow and Melbourne in 2008. I am due back at Strathclyde in March.

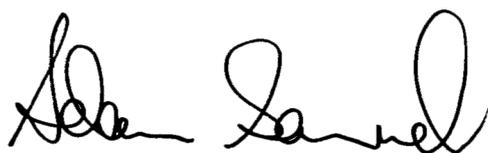
On a trip to Switzerland, Claude Reymond continued to discuss our concerns that the younger generation do not understand where many of the key arbitration concepts (such as separability, competence-competence) come from and as a result do not know how to apply them properly. We have hatched an idea of a conference or series of them or a book on arbitration ideas. The obvious fit would be a conference to celebrate the 50th anniversary of the Paris 1961 conference on the autonomy of the arbitration clause in 2011. However, it would be more fun if we organized something sooner. Any takers?

Corporate deadlock in the financial services field can sometimes be broken by reporting the problem to the Small Firms Division of the FSA. The threat of involvement by the regulator can be used to bring the parties to the negotiating table before it is too late.

I have to help resolve disputes closer to home a few times a year when independent financial advisers (IFAs) contact me with internal business problems. One had a company which was deadlocked with shareholders on either faction holding identical shareholdings. There continue to be disputes about individuals leaving firms and the awkward handling of commission clawback (where business is cancelled and the product provider claims back the amounts paid). Finally, an IFA brought me in to help with the process of terminating a representative's engagement on a basis of an Emmenthaler-like contract!

Otherwise, most of the problems one encounters here could be solved through proper contract drafting and the provision of a decent dispute resolution clause. I have long hoped that the trade and professional bodies would take this subject seriously and perhaps provide a subsidised dispute resolution service. This seems as far away as ever. Perhaps, though, some law firms could work with these organizations to produce some model contracts. This would provide a sensible framework.

It remains only to wish everyone a good safe trip through the perils ahead in 2009 and thank the many individuals scattered around the UK and the rest of the World (particularly Chris Hamblin, this newsletter's editor) who help me to enjoy myself and prosper in 2008.

A handwritten signature in black ink, appearing to read 'Adam Samuel'. The signature is written in a cursive, flowing style with some loops and flourishes.