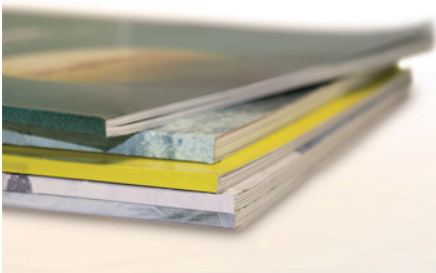


In at the Deep End: Pooling Client Monies in the Isle of Man

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BY JOHN RIMMER

Banks play a crucial role in everyday business and when a bank fails, those exposed panic as they seek to preserve their funds. The insolvency of KSF – an Icelandic bank in the Isle of Man – threw up problems for their account holders. The difficulties unexpectedly drew in others in this case, owing to the rules on pooling of a fund manager’s client funds, and the possibility of showing that funds held at a different bank were not pulled into the pool of client monies.

Singer & Friedlander Investment Management (IOM) Limited (“SFIM”) carried on an investment management business in the Isle of Man. As part of that business, SFIM managed cash belonging to clients.

The **Financial Supervision Commission (General Requirements) Regulatory Code** (“the Code”) and **Investment Business (Clients’ Money) Regulations 1996** (“the Regulations”) were passed under the **Investment Business Act 1991**, which governed SFIM’s business activities. Under the Code and Regulations, money belonging to clients would be held either in “pooled” client accounts or in separate, “designated”, client bank accounts. Designation was to prove very significant to clients. SFIM placed cash deposits with a number of banks, including KSF. The legislation provided that in the event of a failure of a bank monies held

for clients in pooled accounts (wherever situated) would be pooled together, to be shared *pari passu*. In contrast, designated accounts would fall outside of the pool. If the accounts were maintained at the defaulting bank, the client would bear the loss occasioned by the default. If they were not maintained at the defaulting bank, the client would not bear any loss caused by the default.

On the insolvency of KSF in October 2008, clients scrambled for what remained of the client funds, and there were several issues for determination. These included the proper status of money held on behalf of a client in a separate account but with words indicating designation omitted from the title, contrary to the expectations of the client. These issues were considered in a test case involving cash managed for the Isle of Man Treasury and the Isle of Man Water Authority (the “Authorities”).

Importantly, the Code defined “*Designated Client Bank Account*” as one which:

- (a) holds money of one or more clients;
- (b) includes in its title the word “*Designated*” (but not the words “*Designated Fund*”), and;
- (c) the clients whose money is in the account have each consented in writing

to the use of the bank with which the client money is to be held.

Andrew Moran QC, acting Deemster, considered carefully the terms of SFIM's investment management agreements with the clients. He also reviewed the evidence submitted by the Authorities from former officers of SFIM as to the circumstances in which the funds in question came to be held in accounts not labelled in accordance with the Code.

He accepted as fact that the Authorities had intended to protect their funds from the failure of an institution and, consistent with that, had intended to have designated accounts. SFIM intended that they too had separated the funds from its general arrangements, outside the pool, but had not followed the strict wording of the Code in labelling the accounts.

Labelling the Accounts

Having made these findings, the court then had to consider whether the Authorities' funds should fall outside the pool. This involved an analysis of whether the funds were held by SFIM subject to "purpose" trusts and whether when that purpose failed, a resulting trust of the so-called "Quistclose" (see **Barclays Bank Limited v. Quistclose Investments Limited** [1970] AC 567), type arose in respect of the whole beneficial interest in the funds in the Authorities' favour. Broadly speaking a Quistclose trust works as follows:

The payer pays the payee a sum of money. The person providing the funds and the recipient must have a common intention that the funds are applicable only for a particular purpose (whether under an obligation or merely a power). The law implies a trust over those funds in favour of the payer if that purpose is not fulfilled.

Unfulfilled Purpose

The judge decided that Quistclose trusts are not confined to specific circumstances and that it was relevant that there was no intention of SFIM's having the funds at its free disposal: it was specifically and in common intended that the funds would be maintained outside the pool. The judge found that there were Quistclose trusts in this case, based on the unconscionability of the receipt of

funds to be held in designated accounts. He rejected the arguments that the representative for the pool account holders had put forward:-

- i. That the purpose necessary for a Quistclose trust would have to exhaust the beneficial ownership if fulfilled, and would not here.
- ii. That the circumstances within which a Quistclose trust can arise are narrow and confined to existing cases.
- iii. That public policy required that trust law should not "drive a coach and horses" through the regime introduced under the code.
- iv. That the code and regulations deal comprehensively by imposing a statutory trust.

The client was entitled to arrange things so that his funds fell outside pool accounts. At para 108, the judge said (rightly it is submitted):

"[No] provision of the Code and Regulations operates in those circumstances so as to interfere with proprietary rights under the resulting trust in relation to the property."

Accordingly, the Judge agreed with the Authorities that the relevant funds were held upon a resulting trust in their favour and were not subject to the pooling provisions. The ruling will also apply to SFIM's other clients whose accounts were labelled in the same manner.

It seems right to the trust lawyer that monies that can be traced to an individual client should remain his property. The thought that regulations designed to inform how client monies should be held should, owing to a technicality, cause them to fall in with the general client pool seems wholly illogical. Fortunately the court agreed. It is notable that the court felt the need to analyse the legal position nevertheless in strict terms, within specific precedent (the Quistclose line of cases) and not general principle.

Christopher Cope of Appleby Isle of Man acted for the Isle of Man Treasury and the Isle of Man Water Authority.

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