LEGAL ASPECTS OF ASSET MANAGEMENT

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Common legal structures in wealth management are trusts, family partnerships, and limited liability companies. The choice of an appropriate instrument plays an important role, as these instruments define and explain the cause and effect. They impact ability, efficiency, and productivity in achieving the desired goals. However, at times, these instruments become subject to legal issues.[1] This write-up examines the problems arising from asset management legal structures as well as their pros and cons.

Individuals involved in asset management often face manifold legal controversies. The legal issues are sorted out by the courts. The

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[1] There are several legal structures for wealth management such as partnerships, limited liability companies, trusts, offshore companies and hedge funds.

common issues that asset managers or trustees relate to include cross-border taxation, mismanagement of trusts, Ponzi schemes, breach of fiduciary duties, family partnerships, and technological challenges.

Let us examine the nature of these issues.

1. Cross-Border Tax Evasion

A number of U.S. citizens were maintaining their bank accounts with a Swiss bank, namely UBS.[2] The intention behind opening these offshore accounts was to avoid U.S. taxation. The bank, under pressure from the US government, disclosed information about its clients. Despite this disclosure, the bank was penalized for violating US banking rules, and a penalty of 780 million dollars was imposed.

The key issues involved in this conflict related to state sovereignty, cross-border taxation, and money laundering. The US authorities

[2] United States vs. UBS AG (2009), 09-60033 – CR – MARRA: The outcome of the case marked a major shift in banking secrecy laws.

insisted that US account holders had deposited ill-gotten money in Swiss banks. The matter was sorted out through negotiations.

However, even after a negotiated settlement, the US filed a suit against UBS to seek more information about bank's 52,000 US account holders while alleging that the bank and its customers conspired to defraud the US treasury department of its legitimate revenue. These pressure tactics succeeded, and UBS agreed to share information about US citizens.

2. Mismanagement in Trusts.

Many problems arise in the management of trusts. For example, a UK-based trust company failed to account for its tax liabilities regarding an inheritance issue. In Barclays' Wealth Trustee case,[3] a question arose as to whether or not a settlor who became deemed domiciled in a country other than his native country can be subjected to UK's inheritance tax (IHT). The Court of Appeal held that

[3] Barclays Wealth Trustees (Guernsey) Ltd. v. HMRC (2011), [2015] EWHC 2878 (ch).

inheritance tax does not apply to transfers related to exclude properties from the settlement after the settlor becomes domiciled in the UK. This means that non-UK assets held in an offshore company are generally not subject to taxation, even if the settlor later becomes UK domiciled.

3. Investment Fraud through Ponzi Schemes:

India's Saradha Group created a multi-level marketing scheme by promising its investors high rates of return.[4] The schemers defrauded thousands of investors and caused them huge losses. The investigations revealed violations of regulatory requirements and mismanagement of funds through fraud, regulatory lapses, and negligence. To plug these malpractices, the Indian government had to enact a new law laying down strict controls for non-banking financial companies.[5]

[4] Investors were drawn to Ponzi scam as the same was offering a rate of return up to 30%.

[5] The Banning of Unregulated Deposit Schemes Act, 2019. It provides for a comprehensive mechanism to ban the unregulated deposits schemes, other than the deposit taken in the ordinary course of business, and to protect the interests of depositors and for matters connected

4. Improper Advice in Investments

In April 2018, the Commonwealth Bank of Australia (CBA) was involved in a planning scandal.[6] The scandal came to light[7] when it was revealed that customers seeking appropriate financial advice were not given suitable guidance.

The scandal led to a major review of CBA's actions, in which it was found that several financial planners were guilty of misconduct by failing to adequately supervise their financial planning advisory. As a result, several senior executives at CBA had to resign, including the bank's top advisor.

The bank, however, agreed to compensate customers who had been charged for rendering advice and conceded to provide additional

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therewith or incidental thereto. It bans unregulated deposit schemes, fraudulent default in regulated deposits schemes and wrongful inducement in relation to unregulated schemes. The law provides for checking and tackling of the menace of illicit deposit taking activities.

[6] Commonwealth Financial Planning Scandal (2014), Australian Securities and Investment, Commissioner v. Commonwealth Bank: Case No. 38187, 2020 SSC 35.

[7] A whistle blower had revealed how the bank staff committed illegal acts.

compensation to those who had been denied advice. More precisely, the following actions of the bank constituted misconduct.

- Failing to provide appropriate investment advice to its clients.
- The financial planners misled the customers.
- CBA failed to adequately check the performance of its financial planners.
- The bank breached its fiduciary duties.
- Negligence and misguidance were apparent.
- There was misrepresentation, a conflict of interest, and a failure of prudent decision-making.

The confronting situation forced the government to introduce regulatory reforms by enacting appropriate laws to control illegal practices.

5. **Family Businesses and Wealth Disputes.**

Upon the death of Singapore's ex-Prime Minister Lee Kuan Yew, the will papers became the subject of a dispute among the successors.[8] An investigative court[9] in this regard observed the following illegalities and irregularities in settling the will:

1. A singular focus on what one party wants and the same is oblivious to the interests of the testator.
2. In ascertaining the will of the testator, lack of diligence is apparent on the face of record.
3. Mrs. Kwa's actions particularly her desire to exclude certain shareholders, amounts to a failure in following fiduciary duties.
4. False statements were made in front of the testator.
5. The attorney involved did act with a degree of dishonesty.
6. The testator ended up signing a document which was, in fact, not the document he intended to sign.

[8] Law society of Singapore v. Lee Suet Fern: [2020], SGHC 255.
[9] High Court of Singapore.

6. Digital Fraud and Cyber security Risks: Wealthfront Case[10]

Wealthfront, a robo-advisory platform, failed to disclose to its clients their reliance on an automated platform in managing their investments. Wealthfront misinformed its clients, and the customers suffered losses. The investigations revealed a lack of transparency on the part of the wealth manager, who was rendering improper advice to its customers.[11]

The integration of technology in asset management has significantly enhanced operational efficiency but has also introduced challenges related to data privacy, Anti-Money Laundering (AML) compliance, and legal obligations. Several notable cases highlight the complexities and legal implications at this intersection.[12]

Data Privacy Concerns:

[10] Release No. 5086/December 21, 2018: Administrative proceeding file no. 3-18949.
[11] In the matter of Wealthfront advisors, LLC, f/k/a Wealthfront, Inc: Administrative proceeding file No. 3-18949 dated 21-12-2018.
[12] See United States v. HSBC Bank 863. F. 3d: 125C 2nd Cir. 2017. It set a benchmark for penalties and oversight for failing AML compliance programs.

In October 2012, TD Bank faced scrutiny after misplacing unencrypted backup tapes containing extensive customer information, including Social Security numbers and bank account details. The breach affected approximately 267,000 customers, with the bank delaying notification for over six months.[13]

AML Compliance Challenges:

In October 2024, TD Bank[14] admitted to willfully neglecting its AML program for over a decade, allowing trillions of dollars in potentially suspicious transactions to go unchecked annually. The bank's failures included inadequate monitoring of transactions indicative of human trafficking and fentanyl trafficking, and facilitating over $670 million in transactions for a Chinese organized crime ring. As a result, the U.S. Treasury Department's Financial Crimes Enforcement Network (FinCEN) imposed a record-breaking $1.3 billion penalty, contributing

[13] This incident underscores the critical importance of robust data protection measures in the financial sector. See also Equitax Data Bycash settlement (2017), it highlighted the need for straight cyber security measures and the importance of data privacy financial system.
[14] Toronto – Dominion Bank v. Canada, 2012 SCCI; SCR 3.

to a total settlement of over $3 billion across multiple U.S. authorities.[15]

Legal and Regulatory Developments:

In August 2024, FinCEN issued[16] a final rule imposing AML requirements on registered investment advisers, aiming to address illicit finance activities and national security threats in the asset management industry. This development signifies a regulatory push towards enhancing AML compliance within the sector.

Balancing AML and Data Privacy:

The convergence of AML obligations and data privacy regulations presents a complex landscape for financial institutions.[17] Organizations must navigate conflicting requirements, such as the need for information sharing to combat financial crimes versus

[15] This case highlights the severe consequences of failing to maintain an effective AML compliance programs. See also Danske Bank v. AML Scandal (2018).
[16] The Financial Crimes Enforcement Network (FinCEN) August 2024.
[17] United States v. HSBC Bank. 863 F. 3d 125. The case highlighted the importance of AML complaisance in preserving financial crimes.

stringent data protection laws like the General Data Protection Regulation (GDPR). This tension necessitates a careful balance to ensure compliance on both fronts.[18]

Conclusions

There exist serious problems with regard to transparency, compliance and failures to follow fiduciary duties. The rise of digital platforms demands robust cyber security and transparency. Managing wealth across jurisdictions involves navigating varied legal and financial systems.

More strict regulations are needed to check fraud and cheating, particularly in unregulated deposit schemes. For that, new enactments are needed to plug the existing lope holes. The recent actions of FinCEN in this regard guide others to follow.

[18] The cases and developments illustrate the intricate challenges asset managers face in integrating technology while adhering to data privacy, AML compliance, and legal requirements. Implementing robust compliance programs and staying abreast of regulatory changes are essential steps to mitigate risks in this evolving landscape.

The discussion also highlights the importance of clear succession planning and governance in family-owned wealth. The Danske Bank money laundering scandal draws our attention to the need for increased controls for compliance and better communications skills. Asset management collaboration with external vendors on Fintech platforms may expose data to vulnerabilities. Managing wealth in multiple jurisdictions may also create conflict with local data privacy laws.[19]

[19] Introduction to technologies is also introducing privacy risks if not implemented securely.