A Bank's Duty of Care

Edited by
Danny Busch and Cees van Dam

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Introduction

DANNY BUSCH AND CEES VAN DAM

I. Introduction

In recent years, more and more clients and third parties have filed claims against banks such as for mis-selling financial products, poor financial advice, insufficient disclosure of and warning for financial risks. The scope of the duty of care of banks seems to expand: from protection of consumers against unclear risks of complicated products to protection of professional parties and against more obvious risks of relatively straightforward products.

The duty of care of banks raises many questions, both at a theoretical and practical level. The topic is relatively novel and in a state of flux. Many important questions are still in search of clear answers. Comparative law books on the topic are scarce. We therefore ventured to collect information about how various jurisdictions deal with a bank's duty of care and how answers are found or embedded in the national legal system. We also aimed to place a bank's duty of care in a European and comparative law perspective. We hope this book will facilitate cross-border discussion and exchange of ideas on the role and limitations of a bank's duty of care, both in theory and practice. The aim of this book is necessarily modest. Given the dynamic character of the topic, the best this book can offer is a snapshot in time.

II. Scope and Terminology

The book is principally concerned with the duty of care in the area of the provision of investment services, ie execution-only services, investment advice and asset management. However, as will be seen in the next chapters, in many jurisdictions the duty of care applies well beyond this scope.

In all jurisdictions covered, banks offer investment services on a large, if not massive, scale. Nevertheless, independent investment advisers and asset managers may also provide investment services, even though they do not qualify as a bank from the perspective of the applicable regulatory framework. Most of what is said in this book on the duty of care of banks providing investment services equally applies to non-bank entities providing such services, at least as far as the European jurisdictions covered by this book are concerned.

'Duty of care' is not the term of art in all jurisdictions. In common law jurisdictions in particular the term is bound to cause confusion. We essentially aimed to focus on duties to investigate, duties to disclose or warn, and—in exceptional cases—outright duties to refuse to render financial services or offer products, no matter the nature of their legal source. In view of this we adopted a functional approach and also included discussion on fiduciary duties, common law duties (other than duties of care), as well as all kinds of statutory duties. In this chapter and in Chapter 12, we will nevertheless use the term 'duty of care' as convenient shorthand.

III. MiFID

Banks providing investment services have been subject to the Markets in Financial Instruments Directive (MiFID I) since 1 November 2007.[1] On 3 January 2018—some 10 years later—the MiFID I regime will be replaced by MiFID II (in the remainder of this chapter, MiFID I and II are collectively referred to as MiFID).[2] MiFID contains a general duty of loyalty, which to some extent has been fleshed out in more specific conduct of business rules for banks (and others) providing investment services, including detailed duties to investigate (know your customer or KYC rules) and duties to inform.[3] In most of the EU jurisdictions included in this book, it is now commonly accepted that these regulatory rules, especially the conduct of business rules, help to define the pre-contractual and contractual duty of care of banks under private law. Moreover, in many jurisdictions, an infringement of national implementing provisions can constitute not only a breach of the civil duty of care but also a tort (unlawful act)

[1] The MiFID I regime at level 1 and 2 is composed of three measures: (1) Directive 2004/39/EC [2004] OJ L145/1; (2) Commission Regulation (EC) No1287/2006 [2006] OJ L241/1; (3) Commission Directive 2006/73/EC [2006] OJ L241/26. It should be noted that not all Member States of the European Union and countries forming part of the European Economic Area succeeded in implementing the MiFID regime as of 1 November 2007.

[2] The MiFID II regime at level 1 and 2 is composed of the following measures: (1) Directive 2014/65/EU [2014] OJ L 173/349 (MiFID II); (2) Regulation (EU) No. 600/2014 [2014] OJ L 173/84 (MiFIR); (3) a truly impressive number of implementing measures. Initially, MiFID II/MiFIR stipulated that the bulk of the new legislation would become binding on the financial sector as of 3 January 2017, but this has been postponed until 3 January 2018 by means of a directive and a regulation published in the Official Journal on 23 June 2016, see (1) Directive 2016/1034/EU [2016] OJ L 175/8; (2) Regulation (EU) No 2016/1033 [2016] OJ L 175/1.

[3] MiFID I, Art 19(1); MiFID II, Art 24(1).

for breach of a statutory duty. It should also be noted that duties of care under public law and other regulatory provisions are regularly explicitly incorporated into the contract, with all the contractual consequences this entails. This is why the book starts with a detailed chapter on the conduct of business rules pursuant to MiFID.

IV. The National Legal Systems Studied

As for our choice for the national legal systems included in this book, the following factors were leading: (1) a focus on Europe; (2) inclusion of jurisdictions with a major banking sector; (3) inclusion of the most important representatives of the civil and common law legal systems; (4) a fair balance between civil and common law legal systems; and (5) specific substantive law reasons.

It seemed only natural to include the civil law jurisdictions of Germany, France and Italy. They all have a large domestic banking sector and are important representatives of the civil law tradition. Austria, Spain and the Netherlands are less obvious choices, but the inclusion of these civil law jurisdictions is justified for specific substantive law reasons. In Spain and Austria disputes with banks are often resolved by reference to the doctrine of error or fraud. This divergent approach provides an interesting contrast with the other jurisdictions covered by this book, where the focal point is a damages claim for breach of a bank's duty of care. The Netherlands is an interesting jurisdiction for specific substantive law reasons as well, because the Dutch Supreme Court succeeded in developing a coherent and very consumer-friendly body of case-law on a bank's 'special' duty of care (*bijzondere zorgplicht*).

As for the common law jurisdictions in this book, we note the following. The UK has the fourth largest banking sector in the world and the largest in Europe. England and Wales is the most important common law jurisdiction in Europe. Inclusion of a chapter on England and Wales therefore goes without saying, although Brexit may well have an impact on its leadership in the banking sector. Common law jurisdictions are scarce in Europe so it seemed an obvious choice to include Ireland, which over the past few years has also emerged as a major international financial services centre. Both in Ireland and England and Wales the common law plays a more modest role with a stronger focus on statutory actions as compared to continental Europe. We completed the picture with a chapter on the US. The US is clearly outside of Europe, but its inclusion is justified because it is the most important common law jurisdiction outside of Europe and it has a large banking sector. Finally, the inclusion of a chapter on the US strikes a better balance between the civil law and common law jurisdictions included in the book. Moreover, the US and England and Wales are interesting because of the different balance between private and public enforcement and the active role of the regulators in forcing banks to provide remedies to investors.

V. Methodology

It was important to us to provide the authors of the national chapters with flexibility in the preparation of their chapters. The instructions they received were limited to a brief questionnaire with some fairly general questions. We did not seek to impose a certain structure or uniformity in approach in general. We considered it important to allow the contributors to emphasise the principles and remedies which they deemed important in their own legal system. At times, one of the national chapters may discuss an issue not covered in the other chapters. We were happy to include such features, provided that they covered material that was relevant. We saw it as our duty to create the overall picture in our comparative law evaluation (Chapter 12). As long as each chapter provided us with the main ingredients, uniformity of approach in the national chapters themselves was not necessary.

In this book we have used the so-called successive comparative law method, according to which material from national legal systems is analysed first, followed by the comparative law evaluation.[4] In our view, especially in view of the fact that no fewer than nine legal systems are taken into account, this method is the best way of ensuring that the research is clearly organised and can be easily consulted and checked.

VI. Structure of the Book

This book is structured as follows. Part I consists of the present introductory chapter. Part II contains a chapter on the EU regulatory framework: MiFID (Chapter 2). Part III contains the civil law jurisdictions covered by this book: Germany (Chapter 3), Austria (Chapter 4), France (Chapter 5), Italy (Chapter 6), Spain (Chapter 7) and The Netherlands (Chapter 8). Part IV covers the following common law jurisdictions: England and Wales (Chapter 9), Ireland (Chapter 10) and the United States of America (Chapter 11).

Part V contains a chapter on a bank's duty of care from a European and comparative law perspective (Chapter 12). In this final chapter, we focus on five topics which are hotly debated in theory and practice. The first topic is the scope and intensity of the essential duties which typically flow from a bank's duty of care: duties to investigate, duties to disclose or warn, and—in exceptional cases—outright duties to refuse to render financial services or offer products. In some jurisdictions (Spain and Austria), financial disputes between investors and banks

[4] On this subject, see D Kokkini-Iatridou et al, *Een inleiding tot het rechtsvergelijkende onderzoek* (Deventer: Kluwer, 1988) 187–88.

are not so much resolved by reference to a bank's duty of care, but by reference to the traditional doctrine of error or mistake, and fraud. That is the second topic we discuss in this chapter. The third topic is the impact of MiFID on a bank's duty of care. The fourth topic focuses on the role of the financial regulator in settling disputes between banks and clients. Under the heading of a fifth topic we highlight some recent reform proposals which enable us to put the bank's duty of care into a larger perspective.

This book purports to describe the law as it stood on 1 February 2017.

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England and Wales

KERN ALEXANDER*

I. Bank Civil Liability for Mis-selling and Advice

A. Introduction

The financial crisis of 2007–08 and ensuing economic slowdown have resulted in many legal and regulatory claims against UK banking institutions by their customers and third parties for mis-selling financial products and rendering inadequate advice and disclosure regarding their risks. Generally, English law liability rules tend to favour banks and impose a heavy burden on investors and customers to prove breach of any statutory, common law or fiduciary duties. A major hurdle for a claimant bank customer to overcome is to show that the bank owed it a duty of care in the sale of a product or the rendering of advice regarding the risks associated with the bank's products and investments. English common law generally allows a bank and its customer to contract out of the duty of care, resulting in an arm's length relationship between the bank and the customer in which the bank has no obligation to inform or advise its client, nor to reveal any of the risks associated with its product or to assess the suitability of its customer for the products it sells. Without a duty of care, the bank merely has an obligation not to make explicit material misrepresentations to its customers regarding its products.

As a result, claims against banks for breach of a duty of care or fiduciary duties under English law have rarely succeeded. Nevertheless, the impact of the financial crisis resulted in unexpected and crippling losses for millions of individuals and small businesses in addition to substantial losses for professional investors, all of which have resulted in an unprecedented number of civil lawsuits against banks for breach of the duty of care, in particular claims for misrepresentation, negligent advice, failure of the duty to warn and investigate. Moreover, several million complaints have been filed with the UK financial regulator—the Financial Conduct

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Authority and its predecessor the Financial Services Authority—against banks for failing to treat their customers fairly and for breach of other regulatory principles in the sale of financial products.

In addition, the harshness for bank customers of the common law's *caveat emptor* approach to bank sales has been limited to some extent by the English courts in several recent rulings following the financial crisis.[1] Moreover, European Union law has sought to make it more difficult for banks to dispense with the duty of care obligation by contracting and to guarantee certain minimum rights for bank customers—especially small business customers—to recover compensation from banks who have mis-sold financial products. This chapter attempts to understand the nature and scope of a bank's duty of care under English common law and UK statutory and regulatory law. In doing so, it reviews the basic principles of English contract law and related areas of tort and fiduciary duties law. UK regulatory law will be discussed to show how it attempts to reverse the erosion of the duty of care under the common law by requiring banks to treat all of their customers fairly and to adopt governance and organisational structures so that the development of financial products takes due account of the interests of bank customers. Finally, European Union law in the form of the Market in Financial Instruments Directive II will be discussed to show how banks will be required to undertake further reforms in governance and trading practices so that banks will have an obligation to recognise a duty of care for their customers in a far greater number of transactions.

B. The Duty of Care and Freedom of Contract

A fundamental principle of English law, which militates against successful claims against banks, is freedom of contract, whereby parties negotiate their own terms which are generally upheld by the courts pursuant to the doctrine of contractual estoppel to ensure commercial certainty and that a bank does not generally owe a duty of care to its customers to advise on the merits of transactions unless the bank has expressly undertaken to do so in which case the bank would be required to advise with reasonable care and skill.[2] Despite the growth of statutory and regulatory obligations for banks, 'party autonomy is at the heart of English commercial law'.[3] In the absence of statutory or regulatory intervention, the courts give effect

[1] See *Rubenstein v HSBC* [2011] EWHC 2304 (QB) at [83] (discussed below). See also *Crestsign v The Royal Bank of Scotland* [2014] EWHC 3043 (Ch) at [88]–[89], [108].

[2] *Thornbridge Limited v Barclays Bank Plc* [2015] EWHC 3430 (QB) at [6], per Moulder J, upholding that a bank does not have a duty of care to advise a customer on the merits of a transaction unless the bank has undertaken to do so. *Thornbridge* also reaffirms a strict application of the doctrine of contractual estoppel that a bank customer that has signed an undertaking that it has not received advice from a bank on a particular transaction cannot later sue the bank for negligent advice even if the bank in fact had rendered erroneous advice or information about the transaction.

[3] See *Belmont Park Investments Pty Ltd v BNY Corporate Trustee Service Ltd (Revenue and Customs Commissioners intervening)* [2011] UKSC 38; [2012] 1 AC 383, per Lord Collins at [103].

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A Bank's Duty of Care: Perspectives from European and Comparative Law

DANNY BUSCH AND CEES VAN DAM

I. Introduction

The financial crisis of 2007–12 sparked a flood of litigation across Europe and the United States. This may be gleaned from the previous chapters, which all provide an overview of the major cases and affairs in which banks have been subject to litigation and in a number of cases have been held civilly liable to investors for mis-selling financial products, poor financial advice, insufficient disclosure of and warning for financial risks. Many of these disputes and scandals were triggered by the crisis. The chapters mention litigation and affairs on a vast array of financial products and services, including interest rate swaps, futures, options, short sales, structured finance products, payment protection insurances (PPIs), shares, bonds, mutual funds, loan contracts and mortgage lending. Many of these cases are somehow linked to the fall of Lehman Brothers, the US housing crisis and the fraudulent Madoff scheme.

The previous chapters offer a treatment of a bank's duty of care from the viewpoint of national jurisdictions. In this chapter we place a bank's duty of care in a European and comparative law perspective. Looking at the national reports from this angle, the first thing that strikes is that courts throughout the jurisdictions approach the questions with respect to the bank's duty of care in a pragmatic way. They do not seem to feel strongly bound or hindered by dogmatic or theoretical distinctions. For example, the courts do not generally distinguish between consumers and professionals but focus on the circumstances of the case and assess whether the client had sufficient knowledge to understand the financial product that was provided. The more knowledge and experience, the less protection he needs. And vice versa, the less knowledge and experience, the more protection he needs. From this balancing act, the courts find and shape the tools in their national legal system to achieve the outcome they deem to be fair, just and reasonable.

However, even though the courts are similarly pragmatic in their use of legal tools to decide cases, they clearly do not strike the balance in the same way. In particular, they are not equally protective for investors. This does not come as a surprise, as the question what amounts to a fair and just decision very much depends on the legal-cultural and legal-social make-up of the country in which the courts hand down their decision. Hence, courts are pragmatic in choosing the road to their decision and to embed their decision into the legal system but the substance of these decisions differs between the legal systems.[1]

For this chapter, we have chosen five topics which are hotly debated in theory and practice. The first topic is the scope and intensity of the essential duties which typically flow from a bank's duty of care: duties to investigate, duties to disclose or warn, and—in exceptional cases—outright duties to refuse to render financial services or products (section II). In some jurisdictions, financial disputes between investors and banks are not so much resolved by reference to a bank's duty of care, but by reference to the traditional doctrine of error or mistake, and fraud. That is the second topic we discuss in this chapter (section III). The third topic is the impact of the European Markets in Financial Instruments Directive (MiFID) on a banks' duty of care (section IV). The fourth topic focuses on the role of the financial regulator in settling disputes between banks and clients (section V). We conclude this chapter with the bigger picture and relevant reform perspectives (section VI).

II. Scope, Content and Intensity of a Bank's Duty of Care

A. General

i. The Imposed Duties

The picture that emerges from the previous chapters is that the courts typically resolve financial disputes between investors and banks by reference to duties to investigate (also known as Know your Customer or KYC rules) and duties to disclose or warn, often stemming from a duty of care, good faith, fiduciary law or statutory law. As for the Netherlands, the Dutch Supreme Court (Hoge Raad or HR) has many times stated that the position of banks in society brings with it a 'special' duty of care towards consumer clients. According to the Dutch Supreme Court, a bank's special duty of care is also based on the fact that banks are professional service providers which must be deemed to have the necessary expertise.

[1] See eg C van Dam, 'Who is Afraid of Diversity? Cultural Diversity, European Co-operation, and European Tort Law' (2009) 20 *King's Law Journal* 281–308.