Lessons from the Swaps Mis-selling Saga

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Content

- The role of the judiciary versus the Financial Ombudsman Service
- The treatment of small and medium-sized enterprises ("SMEs") by banks, financial institutions and regulators
- Swaps mis-selling in the courts
- Book-ended by five decisions of the Court of Appeal
- Lessons to be learned?

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The role of the judiciary?

- Oligopolistic banking sector with significant bargaining power and access to high end legal resources
- Judicial accommodation of banking practices and boilerplate
- Judges? Ombudsman? Specialist Financial Services Tribunal?
- 1 April 2019: access to FOS massively increased
- A vote of confidence….?!?

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The importance of SMEs

"SMEs are important contributors to economic growth in the UK and valuable clients for financial services firms; between them, 5.4 million SMEs account for 47% of private sector turnover, 60% of employment and 70% of net job creation…"

- Financial Conduct Authority, DP 15/7, *Our approach to SMEs as users of financial services*, (November 2015), para 2.1

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Where do SMEs fit in in FSMA? (1)

- If operated through a corporate vehicle will not get the statutory cause of action under FSMA s 138D and Rights of Action Regs (rendering each rule of COBS a potential mini-tort)
- *MTR Bailey Trading Ltd v Barclays Bank plc* [2015] EWCA Civ 667 (Kitchin LJ, granting permission to appeal from the judgment of HHJ Keyser QC in the Cardiff Mercantile Court: [2013] EWHC 2882 (QB)).
- See also FCA, *Our approach to SMEs* [1.13] and fn 5

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Where do SMEs fit in in FSMA? (2)

- Until recently only individuals and micro-enterprises were eligible complainants to the Financial Ombudsman Service under Part XVI of FSMA and the DISP rules made thereunder
- But all SMEs were probably classified as “retail clients” getting the benefit of the MiFID rules as implemented in COBS, made under FSMA

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Defining SMEs

- European Commission Recommendation 2003/361/EC
- Small Business, Enterprise and Employment Act 2015 ss 33 and 34

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What is an SME? European Commission Recommendation

an **SME** is an entity of any economic form that employs fewer than 250 persons, with an annual turnover not exceeding €50 million and/or a balance-sheet total not exceeding €43 million;

— a **small enterprise** employs fewer than 50 persons, with an annual turnover not exceeding €10 million and/or a balance-sheet total not exceeding €10 million;

— a **micro-enterprise** employs fewer than 10 persons, with an annual turnover not exceeding €2 million and/or a balance-sheet total not exceeding €2 million.

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Increasing concerns about SMEs

"In their inquiries focusing on the banking sector, the Treasury Select Committee (TSC) and the Parliamentary Commission on Banking Standards (PCBS) have each raised concerns that some SMEs may not have appropriate redress options given their limited resources and their inability to obtain redress through the courts. Both have recommended that we examine whether the jurisdiction of the ombudsman service needs to expand to include a greater share of the SME population."

Financial Conduct Authority, DP 15/7, *Our approach to SMEs as users of financial services*, (November 2015) para 4.3

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The FCA response

- Financial Conduct Authority, DP 15/7, *Our approach to SMEs as users of financial services*, (November 2015)
- But then quite an interval until:
- *CP 18/3, Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services* (January 2018)

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The problem

"When things go wrong, some SMEs, particularly smaller businesses, struggle to resolve disputes with financial services firms through the courts and have few alternative routes to seek redress."

CP 18/3, Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services (January 2018), para 1.1

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The proposal

"Our proposals will provide access to the Ombudsman for more than 80% of the approximately 200,000 SMEs who are not currently eligible"

CP 18/3, Consultation on SME access to the Financial Ombudsman Service and Feedback to DP15/7: SMEs as Users of Financial Services (January 2018), para 1.14

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Which small businesses?

- Annual turnover of £6.5 m; and
  - Annual total balance sheet of £5m or
  - Max of 50 employees

The level "below which it is unlikely an SME would have access to financial management and legal expertise." (para 1.18)

PS 18/21, *SME access to the Financial Ombudsman Service – near-final rules* (October 2018), paras 1.16 to 1.23

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A specialist tribunal?

FCA: “We have publicly stated our support for a tribunal that could deal with disputes that fall outside of the ombudsman service’s remit….However we do not have the power to set a tribunal up. This would require primary legislation and is therefore a matter for the Government.”

PS 18/21, *SME access to the Financial Ombudsman Service – near-final rules* (October 2018), para 2.9

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How will the FOS cope with SME complaints?

- Hiring a team of 20 SME investigators with specialist knowledge and skill
- A dedicated microsite
- Concerns about lack of precedent (raised e.g. in relation to the Insurance Act 2015) (para 2.21)
- FOS has the power to refer a complaint that raises “an important or novel point of law with significant consequences”: DISP 3.4.2R

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The rule changes

- New or revised Glossary definitions of:
  - enterprise
  - guarantor
  - micro-enterprise
  - small business
- Revised rule on eligible complainants on DISP embracing small businesses as well as micro-enterprises

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Increasing the FOS limit

- CP18/31, *Increasing the Award Limit for the Financial Ombudsman Service* (October 2018)
- "Based on the ombudsman service's analysis of a sample of 40 high value complaints, the mean compensation for a high value complaint is around £305,000, with a range of £150,000 to approximately £921,000. These complaints relate predominantly to business loans, interest rate hedging products (IRHPs), portfolio management and self-invested personal pensions (SIPPs)." (para 2.20)

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Increasing the FOS limit (2)

- PS19/8, *Increasing the Award Limit for the Financial Ombudsman Service* (March 2019)
- Mixed responses:
- Small personal investment firms opposed any increase especially given impact on PI insurance (para 1.24)
- "All Party Parliamentary Group on Fair Business Banking said that, in principle, the amount of compensation the ombudsman service can award should not be limited, but if a limit was necessary then it should be no lower than £600,000." (para 2.25)

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Increasing the FOS limit (3)

- DISP amended with effect from 1 April 2019
- New complaints: £350,000
- Old complaints: £160,000
- Annual indexation going forward

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The FCA's IRHP Review

- Financial Conduct Authority, Progress of sales through stages of the review as at 30 September 2015
- It identified a 'review population' of 30,804 SMEs of which 14,936 firms had been found by September 2015 to have been mis-sold swaps by the nine banks participating in the review.

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Banks participating in the FCA review

- RBS (including National Westminster)
- Lloyds (including Bank of Scotland)
- HSBC
- Barclays
- Santander UK
- Clydesdale Bank/Yorkshire Bank
- Co-operative Bank,
- Allied Irish Bank Plc
- Bank of Ireland

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Could the Review provide a basis of claim?

- No: *CGL Group Ltd v Royal Bank of Scotland* [2017] EWCA Civ 1073

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Recent figures on IRHP review

"The banks involved agreed to review their sales of IRHPs to unsophisticated customers since 2001. To date, around 13,900 customers have accepted a redress offer and £2.2 billion has been paid out."

"The average pay-out is, therefore, around £150,000,but many will be significantly higher. For example, the average compensation for IRHP complaints in the sample of 40 high value complaints reviewed by the ombudsman service to support our analysis was approximately £373,000, with a range of approximately £181,000 to £921,000." (CP 18/31, para 2.30)

- See also CP18/31, paras 2.38 to 2.41 on the inadequacy of litigation options or access to justice in the courts for SMEs with claims of under £1 million.

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Swaps mis-selling in the courts

- Book-ended by five decisions of the Court of Appeal, although the first two are investment cases, but not swaps cases:

(1) *Peekay* (2006)

(2) *Springwell* (2010)

(3) *Green v Royal Bank of Scotland* (2013)

(4) *Property Alliance Group* (2018)

(5) *First Tower Trustees Ltd v CDS* (2018); albeit not a swaps nor an investment case

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Peekay and *Springwell*

- *Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386; [2006] 2 Lloyd's Rep 511; revsg [2005] EWHC 830 (Comm).
- *Springwell Navigation Corporation v JP Morgan Chase Bank* [2010] EWCA Civ 1221; [2010] 2 CLC 705; affg [2008] EWHC 1186 (Comm) and [2008] EWHC 1793 (Comm)
- Decisively established "contractual estoppel"

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The critique

Gerard McMeel, “Documentary Fundamentalism in the Senior Courts: the Myth of Contractual Estoppel” [2011] *Lloyd’s Maritime and Commercial Law Quarterly* 185

- contractual estoppel an illegitimate form of estoppel
- likely extension from super-HNWs to ordinary businesses
- reluctance to use statutory controls

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Green v RBS: a disastrous start

Green v Royal Bank of Scotland plc

[2013] EWCA Civ 1197, [2014] Bus LR 168 set the (wrong) tone for English decisions

- perversely treated the restrictive approach to statutory claims under FSMA s 138D(2) as a reason to curtail common law rights in negligence, rather than expand them.
- refusal to recognise a duty to advise, rather than a duty to provide information

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Green v RBS (2)

- Difficult to see how this approach can be reconciled with existing common law authority on the standard of care eg *Seymour v Caroline Ockwell & Co* [2005] PNLR 39 [77], *Shore v Sedgwick Financial Services Ltd* [2008] PNLR 10 [161]
- Completely overlooked MiFID, especially rules on appropriateness of complex investments, and the EU principle of effectiveness.

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First instance cases (1)

- *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch) [2015] 2 All ER (Comm) 133
- Permission to appeal granted: [2015] EWCA Civ 986.
- An appeal to the Court of Appeal was scheduled to take place in the first half of 2016 but settled.

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Crestsign

- The Judge concluded that this was a case typical of the regulatory failings found by the FSA in 2012 in its pilot findings on swaps: “[P]oor disclosure of exit costs … ; failure to ascertain the customer’s understanding of risk; non-advised sales straying into advice; a mismatch between the duration of the hedge product and the underlying loan; and rewards and incentives being a driver of such practices.”
- But applying *Peekay* and *Springwell* the bank had successfully disclaimed responsibility for advice, and was immune from challenge under UCTA.

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First instance cases (2)

- *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB)
- Husband and wife commercial property company. The swap's break costs were an eye-watering £565,000.
- Judge Moulder refused to accept that the bank's "Corporate Risk Adviser" had provided advice, and in any event even if advice was in fact given, the Bank had not assumed an advisory duty.

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Thornbridge

- HHJ Moulder noted that Barclays had not charged a fee for investment advice (overlooking the other financial benefits of the transaction) and indicated that this told against an advisory relationship.
- The Judge then reinforced this ‘no advice’ conclusion by reference to boilerplate terms, which she held did not re-write history.

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Critique of *Crestsign* and *Thornbridge*

Gerard McMeel, "The Impact of Exemption Clauses and Disclaimers: Construction, Contractual Estoppel and Public Policy" in A Dyson et al, *Defences in Contract* (2017)

- Decisions antithetical to both UK and EU public policy
- Domestic statutory controls on exemption clauses (which should not be watered down)
- Ignored EU and UK goal of investor protection (from Gower to MiFID)

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Parmar v Barclays Bank plc

- [2018] EWHC 1027 (Ch) (16 May 2018)
- Said to be first swaps mis-selling case to reach a full trial which concerned whether there had been compliance with the COBS rule for a claimant who was both a private person (under FSMA s 138D) and classified as a retail client under COBS (para [113])

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Parmar v Barclays Bank plc (2)

- Held to be a non-advised sale by the bank's representative from "Corporate Risk Advisory" (although reasoning relied heavily on *Thornbridge*) (at [120])
- However accepted COBS 2.1.2R prevented a bank creating an "artificial basis for the relationship, if the reality is different" (going wider than UCTA) (para [133])

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Parmar v Barclays Bank plc (3)

- No breach of COBS 10 (appropriateness) (paras [139-41])
- If COBS 9 (suitability) had applied – the swaps were suitable
- Two flaws in presentation of the investment (para [218]), but they did not prevent Mr Parmar properly understanding the swaps (at [222])
- Therefore no breach of COBS 2.1.1R (client's best intersts rule)

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Respite from an unexpected source…

- *First Tower Trustees Ltd v CDS (Superstores International) Ltd* [2018] EWCA Civ 1396, [2019] 1 WLR 637 (19 June 2018)
- Commercial lease of bays in a warehouse
- Reply to pre-contract enquiries stating that unaware of any environmental problems
- 2 weeks before lease L's agent received a report indicating problems with asbestos

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The provisions

- Clause 5.8 of the lease:
- “The tenant acknowledges that this lease has not been entered into in reliance wholly or partly on any statement or representation made by or on behalf of the landlord.”
- Contrast clause 12.1 in agreement for lease
- Pre-contract enquiries expressly provided that it would up-date any answers if they became incorrect.

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First instance

- Michael Brindle QC sitting as a Judge of the Ch D [2017] EWHC 891 (Ch), [2017] 4 WLR 73 gave judgment to the tenant for £1.4 million
- Rejected argument this was a “basis clause” – rather clause 5.8 was an attempt to exclude liability for misrepresentation
- Held clause 5.8 did not satisfy the requirement of reasonableness in s 3(1) of the Misrepresentation Act 1967 and s 11(1) of the Unfair Contract Terms Act 1977

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On appeal: Lewison LJ

- Referred to "so-called 'basis clauses'" (at [16])
- One simply asked what would the position have been if clause 5.8 not included – L would have been liable for misrep (at [41])
- Much doubt cast on HHJ Moulder in *Thornbridge v Barclays Bank plc* [2015] EWHC 3430 (QB) (swaps case – no advice clause) (at [44], [49] and [65-66])

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Lewison LJ (2)

- So-called “contractual estoppel” established at level of CA: But the position at common law is not the end of the enquiry: is there a “statute to the contrary”?
- See *Springwell* [2010] EWCA Civ 1221, [2010] 2 CLC 705, [143], [181-2] (reviewed a NRC under UCTA)
- “Section 3 of the 1967 Act must be interpreted to give effect to its evident policy. That policy … is to prevent contracting parties from escaping for liability for misrepresentation unless it is reasonable for them to do so.” (at [51])

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Leggatt LJ

"The decision to make section 3 applicable to all contracts induced by misrepresentation, irrespective of the nature and subject matter of the contract and the identity of the contracting parties, is readily understandable. The importance which English law attaches to the freedom of parties to contract on whatever terms they choose depends crucially on the assumption that their consent to the terms of the contract has been obtained fairly. That is not the case where one party's consent has been induced by a misrepresentation made by the other contracting party. Misrepresentation is a paradigm "vitiating factor" which undermines the validity of a contract. This does not mean that a party cannot choose to give up the right to complain that its consent to the terms of the contract was obtained by misrepresentation. But in so far as a contract term is said to have removed that right, a control mechanism is needed to ensure that this term was a fair and reasonable one to include. That, at all events, is the policy which Parliament has thought it right to adopt. It is the duty of the courts to uphold and not to subvert that policy choice."

The impact on the swaps cases

- Status of *Green v RBS*?
- Status of *Crestsign*?
- Status of *Thornbridge*?

- Role of the judiciary in financial services disputes in the future?

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