Investment Mis-selling and Breach of Statutory Duty:

Al Sulaiman v Credit Suisse Securities (Europe) Ltd [2013] 1 All E.R. (Comm) 1105; Rubenstein v HSBC Bank Plc [2013] 1 All E.R. (Comm) 915

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Introduction

The financial meltdown of September 2008 and the ensuing collapse of investments generated a series of claims based on mis-selling. Two recently reported decisions have dealt with actions based on breach of the statutory duty set out in s.150 of the Financial Services and Markets Act 2000 to ensure private customers understand the nature of risks involved and to ensure suitability of advice. The first instance decision in Al Sulaiman was decided primarily as a matter of fact while the judgment of Rix L.J. in Rubenstein considered the nature of the statutory duty and issues of “SAAMCO” foreseeability of the meltdown itself, in other words, whether the adviser should be liable for loss caused by the market collapse.

The Financial Services and Markets Act 2000

Section 150(1) of the 2000 Act provides that a contravention by an authorised person of a rule (contained in the Financial Services Authority’s Conduct of Business handbook, up to October, 31 2007, and the subsequent Conduct of Business Sourcebook) is actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty. In essence both sets of rules required the authorised person to take reasonable steps to ensure a recommendation was suitable for the client and to ensure that the client had the necessary experience and knowledge to understand the risks involved.

Taking “reasonable steps” to ensure that an investment is suitable for a client involves taking reasonable steps to ensure that the client understands the risks involved in the transaction, with the rules being concerned with substance and not form so that if an investment was suitable it did not ultimately matter if there had been failings in the process (Zaki v Credit Suisse (UK) Ltd [2013] EWCA Civ 14). The need to explain the risks is placed in the overall context of suitability, bearing in mind the client’s investment objectives, risk tolerance, knowledge, experience and financial standing. Civil litigators will recognise the difficulty for both adviser and client in identifying whether the suitability tests, because of their wide-ranging definition, have been either satisfied or breached.

Al Sulaiman

In 2005 the claimant A was advised by the second defendant P to invest the significant proceeds of her divorce settlement in financial products sold by the first defendant, Credit Suisse Securities (Europe) (“CSSE”), and in particular leveraged structured notes which had the potential to generate greater profit but also greater loss and which allowed the lender to make margin calls in
the event that the underlying investment lost value. A accepted the advice but in autumn 2008, following the collapse of Lehman Brothers, a margin call was made which she failed to meet and, as a result, the notes in her portfolio were liquidated (when stocks were at rock bottom) so that she lost all of the equity in her investments as well as being liable on the loans used to leverage the notes. A sued CSSE and P for breach of statutory duty, claiming in essence that there had been a complete failure to advise. The issue for the judge was whether, in breach of statutory or common law duty, CSSE and P had taken reasonable steps to ensure that A understood the nature of the risks involved in buying the notes with leverage and in particular the risks inherent in potential margin calls and the results of failure to meet them.

Cooke J. noted at [18] that it was common ground that a duty of care in contract and tort added little or nothing to statutory duty since the reasonable steps required under the rules correlated with the exercise of reasonable care required in contract and tort to achieve the same end (Rix L.J. in Rubenstein did not agree). He did not find any of the witnesses entirely satisfactory and said that, as in many cases, the contemporary documents and the inherent commercial probabilities were the surest guide to assessing the reliability of evidence given (at [38]). However, he found A’s evidence impossible to credit and concluded that there had been no breach of statutory or any other duty in explaining the risk of the investments; A had invested in riskier stocks before and was found to have a reasonable understanding of financial markets so that her claim of a complete failure to advise was unsustainable. The judge added that it was only the unforeseeable events of October 2008 which had brought disaster.

The judge noted briefly that CSSE had also argued in relation to the scope of the duty and the loss actually suffered and that losses occurring as a result of an unforeseeable market collapse were not recoverable. While he saw “much force to these arguments”, he did not need to decide the because he had rejected the case on liability (at [212]); this was also a finding with which Rix L.J. disagreed in Rubenstein.

**Rubenstein**

By contrast, the claimant R was a private retail customer looking for a safe place to deposit the substantial proceeds of the sale of his family home (£1.25 million) while looking for another house. He was looking for an investment which, if possible, paid a higher rate of interest than a deposit account and said that he would invest the sum for approximately a year. He was advised by the defendant, HSBC, to invest in an AIG product on the basis that it was viewed by HSBC as “the same as cash deposited in one of our accounts”; in fact this advice was wrong because it was riskier than a cash deposit. Three years later, following an “unthinkable run” on AIG in September 2008, the product was closed by AIG and R suffered a cash loss of £180,000. The judge at first instance held that HSBC had been in serious breach of statutory and common law duty in the advice it gave and the recommendation it made and that R had relied on that advice, but he only awarded nominal damages on the ground that the loss was ultimately caused by the “extraordinary and unprecedented financial turmoil which surrounded the collapse of Lehman Brothers”. R appealed.

Rix L.J. noted that the judge had not drawn a distinction between statutory and common law duty. However, he said at [114] that in a case of statutory duty the question as to the scope of duty had to be answered by reference to the statute, with the position in negligence and contract “falling in behind”. The statutory purpose of the 2000 Act was to afford a measure of carefully balanced consumer protection to the private person. The judge had found that HSBC’s adviser had understood neither the client he was advising nor the product he was recommending; in fact he had not even understood that he was advising rather than merely executing R’s instructions. He
had failed to follow the standard statutory procedures designed to protect the client and misled him into thinking that he had invested in something which was the same as cash.

“This is not, to my mind, a promising context in which to find that a loss suffered as a result of following a recommendation to enter into an unsuitable investment, when that loss came about because of the very factor which made the investment unsuitable (namely its inherent susceptibility to risk from market movements) was too remote to be recovered from the defaulting advising bank.”

Accordingly Rix L.J. rejected HSBC’s argument that Lord Hoffmann’s analogy in South Australia Asset Management Corp v York Montague Ltd [1997] A.C. 191 of the mountain climber’s knee (a doctor who negligently advised a patient that his knee was fit to climb would not be liable if the patient, relying on that advice, was injured while climbing from a cause not related to his knee) applied to limit its liability. The doctor had not advised, let alone recommend, his patient to go mountaineering; he merely told him that his knee was in good shape. HSBC, however, had in the words of Rix L.J. recommended a particular investment and

“put him in it. If such an investment goes wrong, there will nearly always be other causes (bad management, bad markets, fraud, political change etc.): but it will be an exercise in legal judgment to decide whether some change in markets is so extraneous to the validity of the investment advice as to absolve the adviser for failing to carry out his duty or duties on the basis that the result was not within the scope of those duties.” (at [103]).

He asked what was new about a failure of confidence in marketable securities in which there had previously been greater confidence. “Nearly all the greatest losses come out of a cloudless sky” (at [119]).

Rix L.J. had more sympathy for HSBC’s argument, based on the short-term nature of R’s investment, that a loss two years outside of the period about which R spoke was simply beyond the scope of the bank’s duties of care and foresight; he described it as a powerful submission but was not persuaded by it since it was HSBC’s breach of duty in advising that the investment was effectively an instant access account that led R to think that his investment was safe and did not require to be reviewed in light of changing financial weather. However, Rix L.J. rhetorically asked that if the scope of the bank’s duty was not set by the one year spoken to by R, what was it set by; “three years, ten years, twenty years?” He answered his question by reference to the context of statutory protection for the consumer which should lead HSBC reasonably to contemplate that, if it misled its client as to the nature of its recommended investment and put its client into an investment which was unsuitable for him, when it could just as easily have recommended something more suitable which would have avoided the loss in question, it might well be liable for that loss. Since the obligation to explain matters properly to its clients had been put by statute on the advising expert, then if HSBC wanted to be protected by some relevant, albeit indefinite, time limit for its advice, then the obligation of making that limitation clear rested on the recommending expert, not on the misled consumer (at [123]).