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Investment Advice: the Statutory Remedy

Keith Stanton

This article considers a tort which has received remarkably little comment: that found in s 138D(2) of the Financial Services and Markets Act 2000. The tort creates a very important consumer remedy in cases of mis-selling of financial products by banks and investment advisers. In tort terms it is a prime example of a modern form of breach of statutory duty. It is a statutory strict liability remedy for pure economic loss. The article will consider the features of the tort and how it operates in the context of other remedies: in particular, how the rules governing it influence concurrent claims brought in negligence.

Introduction

This paper will consider an aspect of the law concerning the professional liability of investment advisers. It will evaluate both the features of the tort which is found in s 138D(2) of the Financial Services and Markets Act 2000 (FSMA)¹ and the relationship of that tort to tortious and contractual negligence liability.²

Investment advice is an area which diverges from traditional professional negligence law in a number of ways. First, it features a tortious remedy which is heavily based on regulatory provisions.³ Secondly, the remedy is unusual in the area of professional liability law in being largely derived from European Union law. Finally, because, alongside the familiar picture of concurrent professional liability for negligence in contract and tort, this tort adds a statutory strict liability tort which provides a remedy for pure economic losses.

The s 138D(2) tort is an important element in the protection provided to those who obtain investment advice from independent advisers, banks or others. It gives to a private person⁴ damaged by a breach of a rule⁵ contained in the Financial Conduct Authority's (FCA's) Handbook an express right to seek compensation for their losses.⁶ A

¹ Prior to amendments made to the Act by the Financial Services Act 2012, the relevant provision was s 150 of the Act. The origin of the provision is s 62 of the Financial Services Act 1986.

² I do not propose to consider issues of limitation of actions, although such issues do feature in a number of cases.

³ Note that throughout this article I will refer to rules within the Financial Conduct Authority's (FCA's) Handbook. After the first citation, I will simply refer to them by the Chapter and rule number. Thus FCA Handbook, Conduct of Business Sourcebook (COBS), Chapter 2 Rule 1.1 will simply be referred to as COBS 2.1.1R. The R indicates that the provision has the status of a rule as opposed to being guidance (indicated by a G) or an evidential provision (E). The abbreviations used are those used by the FCA within the Handbook as chapter headings. The Handbook can be accessed at <https://www.handbook.fca.org.uk/handbook>. Note that there are occasional references to sections of the Handbook (Conduct of Business (COB) and Insurance Conduct of Business) (ICOB) which have been superseded.

⁴ See post p xx for a discussion of the meaning of 'private person.'

⁵ See ante n 3. Note that s 138D(3) stipulates that: If rules made by the FCA so provide, sub-s (2) does not apply to a contravention of a specified provision of the rules. The most important rules excluded from actionability are those contained in the Financial Conduct Authority Handbook 'Principles for Businesses' (PRIN) 2.1.1R. See PRIN Sch 5.4.

⁶ Section 138D(1) creates an equivalent rule in relation to rules made by the Prudential Regulation Authority. The author knows of no case in which this provision has been invoked.

wide range of rules, many of which are consumer protection measures derived from EU requirements,⁷ fall within this provision and can thus give rise to a claim in tort. For the purposes of this paper, I intend to concentrate on what has proved to be the tort's major role in practice: claims against investment advisers who have recommended or sold financial products to private customers.⁸

It seems likely that this tort will continue to be important. Since its introduction in 1986⁹ it has provided a remedy for persons damaged by significant examples of mis-selling of financial products. The older cases feature the mis-selling of equity release schemes¹⁰ and private pensions to clients.¹¹ In recent years there has been a spate of cases alleging mis-selling of interest rate hedging products.¹² It seems likely that misadvising and mis-selling following from the recently introduced pension freedoms will provoke a further wave of litigation. The substantial value of wealth that can be tied up in investments such as pension funds means that failures to advise properly may well result in disputes.

The Features of the Statutory Tort

Section 138D(2) states that:

A contravention by an authorised person of a rule made by the FCA [the Financial Conduct Authority] 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.

Section 138D(2) itself creates no single tort. What it does is make actionable breach of a large number of detailed regulatory rules enacted in the FCA's Handbook.¹³ Indirectly, the s creates a host of different tortious obligations.

The provision creates a strict liability statutory tort which gives recovery for pure economic loss.¹⁴ The notion of a statutory tortious liability for pure economic loss is, for two reasons, not as surprising as it might seem at first sight. First, it is not unique as there are other statutory provisions which produce the same result.¹⁵ Secondly, the s 138D(2) tort operates in a context in which there is usually a very close relationship between an investment adviser and client. This is exactly the kind of proximate, akin to contractual, professional relationship which would lead to the tort of negligence imposing a duty of care in relation to pure economic loss under the *Hedley Byrne* principle.

⁷ For current purposes, the most important piece of EU legislation is the Markets in Financial Instruments Directive (MiFID) European Parliament and Council Directive 2004/39/EC OJ 2004 L 145/1. A revised version (MiFID 2: 2014/65/EU) has been adopted: see http://ec.europa.eu/finance/securities/isd/mifid2/index_en.htm. It is now scheduled to be in force by 3 January 2018. It is not likely to have any impact on tort litigation under s 138D(2).

⁸ Other areas of FCA rules which may give rise to claims under s 138D(2) concern: banking, insurance mediation, collective investments, distance selling, e-commerce, mortgage credit and consumer credit.

⁹ See n 1 ante.

¹⁰ *Investors Compensation Scheme Ltd v West Bromwich Building Society* [1999] Lloyd's Rep PN 496.

¹¹ *Loosemore v Financial Concepts* [2001] Lloyd's Rep PN 235.

¹² *Crestsign Ltd v NatWest & RBS, Grant Estates Ltd v Royal Bank of Scotland Plc, MTR Bailey & Anr v Barclays Bank PLC, Thornbridge Ltd v Barclays Bank Plc, Titan Steel Wheels Limited v Royal Bank of Scotland plc*.

¹³ The closest analogy is the now reversed s 47(2) of the Health and Safety at Work Act 1974 which made regulations made under the Act actionable in tort.

¹⁴ See further Keith Stanton, 'Legislating for Economic Loss', in TT Arvind and Jenny Steele (eds), *Tort Law and the Legislature* (Hart Publishing, 2013).

¹⁵ For example, Competition Act 1998, s 47A.

The express references in the provision to it having 'the incidents of the tort of breach of statutory duty' mean that the statutory liability is classed by English law as tortious even though the circumstances which give rise to it commonly occur in a contractual context. The tortious characteristic may be of importance when third parties, such as beneficiaries of pensions or insurance policies, have an interest in a financial product¹⁶ or where recommendations have been made by an advisor outside of a contractual relationship with a view to achieving a sale.¹⁷ It also ensures that contributory negligence is available as a defence and has implications for calculation of damages and the running of limitation periods.¹⁸

Putting technicalities to one side, s 138D(2) is a remedy which protects individuals who are mis-sold financial products. The duty is not an absolute one: liability is not established simply on proof that the defendant caused damage. But, it is strict because proof of negligence is not a necessary criterion for liability. Criteria, such as 'suitability' are used to govern the issue. As such, the law here is a close relation to the obligation in a sale of goods contract to supply goods of 'satisfactory' quality¹⁹ and of the Consumer Protection Act 1987's requirement that products are not 'defective.'²⁰ Such criteria differ from negligence in that the critical issue is a consideration of the result (is the product 'suitable,' 'satisfactory,' 'defective' or not?) rather than of the process that gave rise to that result (was reasonable care taken in the process?).²¹ The statutory obligation can also be a positive one (the adviser must supply certain information: ie provide a positive benefit) rather than the traditional negative approach of negligence which requires a person to take care to avoid causing damage (ie a loss) to a reasonably foreseeable person. None of this means that the statutory tort cannot closely resemble negligence. The process of crystallisation²² can bring them together.

As is common in relation to statutory torts, this tort offers protection (albeit enhanced protection) in a defined set of circumstances. It is not a comprehensive remedy: it covers a limited area. The statutory wording means that recommendations to purchase a product are covered but general advice to adopt a particular investment strategy is not, unless such a recommendation has been made. Similarly, tax and estate planning are outside of the statute unless recommendations are made to purchase or sell particular products as part of the strategy to be adopted. As is the case with industrial safety legislation, a statutory model can provide a far more detailed prescription as to the conduct required. But, on the other hand, negligence, as a general tort, can operate in areas which the statutory protection misses: for example, because of the restriction of the statutory remedy to 'private persons'.²³ The statutory tort coexists with the tort of negligence in this area: it has not succeeded in supplanting it. From a professional liability standpoint, the existence of the statutory tort means that an investment advisor faces a trilogy of concurrent remedies if a defective recommendation to purchase a product is given to a private client. The traditional duties to show reasonable care and skill in advising based on contract and tort are supplemented by a strict liability tortious duty which has different characteristics.

¹⁶ See, for example, *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14 in which it is stated (at para 27) that the products were purchased 'in part for succession purposes.'

¹⁷ *Worthing v Lloyds Bank plc* [2015] EWHC 2836.

¹⁸ The extension of the limitation period permitted by Limitation Act 1980 s 14A only applies to actions alleging negligence.

¹⁹ Consumer Rights Act 2015 s 9.

²⁰ Consumer Protection Act 1987 s 3.

²¹ For example, no tort is committed if a product recommended is 'suitable' even though the procedure used to achieve that result was defective. See post p. xx. Conversely, a product can be 'unsuitable' irrespective of the fact that all reasonable care was taken in producing the recommendation.

²² See post p. xx.

²³ See post pp. xx.

Poor investment advice is also an area in which a non-litigious remedy plays an important role. The Financial Ombudsman Service (FOS) offers a free dispute resolution service to private persons and some small businesses²⁴ in relation to the actions of FCA 'authorised persons.'²⁵ Successful complaints worth less than £150,000 are enforceable through the FOS jurisdiction. In practice it is difficult to see why anyone who has a complaint which falls within the FOS jurisdiction would resort to litigation. This means that s 138D(2) claims tend to centre on mis-selling and acquisition of investments where losses are in excess of the FOS limit of £150,000. The cases therefore concentrate on major investments by high net worth individuals: the sale of interest rate hedging products, pensions mis-selling (where the capital value of the fund may often exceed the FOS limit), equity release plans and treatment of temporary high balances (such as the proceeds of property or business sales).

One of the major problems presented by this area of law is its fragmented and inaccessible structure. The apparent simplicity of s 138D(2) is undermined by the fact that the relevant rules, breach of which are made actionable by the provision, are scattered around the FCA's Handbook and cover a wide range of issues, some of which are unlikely to cause the kind of damage to individuals that will result in a claim for compensation. The range of Handbook rules breach of which are actionable under this provision is massive. There is no paradigm of the tort. The Handbook is too diverse in the subjects it covers to permit this. However, two factors operate to limit the role of the tort. First, it is only actionable by a 'private person.' Secondly, many breaches of rules which damage private persons are likely to have limited financial impact and thus be more suitable for resolution by FOS.

Before considering the areas in which the tort has had the greatest impact it is necessary to consider the major limitation on its scope caused by the 'private persons' threshold.

The 'private person' threshold

Section 138D(2) states that only a 'private person' who suffers loss as a result of the contravention of rules can invoke it. The result of this restriction is that the tort of negligence retains a major role in the many situations in which this condition is not satisfied. The correct meaning of 'private person' has spawned litigation. The definition is not simple. The most important issue is the extent to which businesses are able to bring themselves within it.

The definition of 'private person' is found in reg 3(1) of the Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 (ROA).²⁶

In these Regulations, 'private person' means—

- (a) any individual, unless he suffers the loss in question in the course of carrying on—
 - (i) any regulated activity; or
 - (ii) ...
- (b) any person who is not an individual, unless he suffers the loss in question in the course of carrying on business of any kind.

Subregulation 1(a)(i) is non-problematic. The exception ensures that individuals (such as independent financial advisers operating as sole traders) who are conducting regulated activities are excluded from the statutory protection when receiving advice

²⁴ See post pp. xx.

²⁵ Financial Services and Markets Act 2000, Part XVI. Financial Conduct Authority Handbook Dispute Resolution: Complaints (DISP) 2.7.3R.

²⁶ SI 2001/2256.

from others in the industry. However, the wording of paragraph (b) is more difficult as it opens the door to claims being brought under the s by businesses claiming that they were not conducting business activities at the time when they received the advice. The provision was originally intended to permit charities to be protected in relation to advice received concerning their investments.²⁷ However, it has been a fruitful source of litigation as trading businesses have sought to obtain the benefit of statutory protection. As a matter of statutory interpretation, this is a difficult argument to accept. For example, it seems counterintuitive to say that a business is not indulging in business activities when arranging funding to support those activities. In the case of a business trading in second hand vehicles, it is surely wrong to argue that advice on how the business should fund its stock is not part of carrying on the business. It should be no different if that advice extends to recommending interest rate protection of its borrowing by means of a hedging product. Equally, one would expect advice as to the business's insurance or pension arrangements to be regarded as part of the business even though the product purchased may not be specifically related to cars. If it is correct that the statutory protection is not owed on such facts, the claimant business may still be able to invoke a tortious or contractual claim for professional negligence.

Attempts to bring businesses within the protection have generally been rejected when raised at first instance. In *Titan Steel Wheels Limited v The Royal Bank of Scotland Plc*²⁸ it was argued that the company's use of foreign exchange products for hedging against currency risks was incidental to its business because it did not trade in them. However, this contention was rejected. David Steele J held that the words 'in the course of carrying on business of any kind' should be given a wide reading and that, in any case, the frequency in which the company bought forward currency and the fact that it had regularly made profits on such transactions meant that such dealing would have counted as part of its business even if a narrower interpretation of those words had been preferred. The result in *Titan Steel Wheels* was followed at first instance in *MTR Bailey Trading Limited v Barclays Bank PLC*.²⁹ In that case the company argued unsuccessfully that its business was to deal in vehicles and property and not in financial instruments and thus that its acquisition of a swap did not occur in the course of its business and that it was therefore a private person and entitled to invoke s 138D(2).

However, the issue cannot be regarded as closed as the first instance results were questioned when the Court of Appeal permitted the claimant company to appeal the point in *Bailey* on the basis that its case was arguable. It is suggested that when an appeal court addresses the issue, the approach in *Titan* is the correct interpretation of the legislation. However, there are two additional points to be considered.

First, it must be emphasised that the distinction between private and a non-private person for actionability purposes is not identical to the MiFID derived retail/professional client distinction³⁰ used within the FCA handbook to define the level of protection which a firm must offer to different categories of client. The great majority of individual investors will be both 'private persons' under the ROA and classified as 'retail' clients by the FCA.³¹ However, individuals have a right to ask to be classified as 'elective professional clients' and firms can permit this reclassification if specified conditions are satisfied.³² Such a reclassification does not, however, remove that individual's right of action as a private client under s 138D, although it makes it more likely that the client is

²⁷ The history of the provision is set out by David Steele J in *Titan Steel Wheels Limited v The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm) at paras 52 to 60.

²⁸ [2010] EWHC 211 (Comm).

²⁹ [2015] EWCA Civ 667. See also the decision of the Outer House of the Court of Session in *Grant Estates Ltd v Royal Bank of Scotland PLC* [2012] CSOH 133.

³⁰ This categorisation is derived from MiFID.

³¹ COBS 3.4.

³² COBS 3.5.3.

receiving a non-advised service (ie one where they make their own decisions rather than receiving recommendations as to what to purchase). Conversely, many businesses fail to satisfy the definition of a 'per se professional' client³³ in the FCA Handbook's Conduct of Business Sourcebook (COBS) and, as anyone who fails to do that is automatically deemed a 'retail' client,³⁴ they are retail clients but not private persons and therefore receive additional protection under FCA rules but, do not have a right to claim under the statutory tort. Such complexity is difficult to justify.

Secondly, whatever the correct interpretation of the existing rule, it is arguable that some businesses ought to be brought within the protection of s 138D(2). For example, recently reported litigation has shown that some businesses have been sold exceptionally complex hedging products which had features which were only understood fully by highly specialised bankers. There is therefore an argument that these businesses were entering contracts in a position of such inequality of skill and knowledge that they ought to have access to the statutory tort remedy.³⁵ Indeed, when the FCA conducted its review of Interest Rate Hedging products, it used the term 'unsophisticated customers' in order to bring both 'private customers' and 'retail clients' within the scope of its work.³⁶ The redress scheme set up as a consequence of the review has paid compensation to 18,200 businesses.³⁷

There is a discernible trend towards extending consumer protection rights beyond individuals. For example, the government has been consulting on whether to extend the consumer level of sale of goods protection to small businesses.³⁸ The Financial Ombudsman Services's jurisdiction is open to 'micro-enterprises' ie businesses which have an annual turnover of up to two million euros and fewer than ten employees.³⁹ The result is that, if the *Titan Steel Wheels* result is upheld, the threshold for accessing s 138D(2) will be much higher than that for taking a claim to FOS. Furthermore, as we have already seen, COBS uses definitions of 'per se professional clients'⁴⁰ which permit substantial businesses to receive the enhanced protection afforded to retail clients, even though they are denied tort rights.

It is arguable that the law would be simpler and fairer if all 'retail clients,' as defined by MiFID, were protected by s 138D(2). An attempt to achieve that result by challenging the 'private persons' restriction on the ground that it breached EU law was unsuccessful in the Outer House of the Court of Session in *Grant Estates Ltd v Royal Bank of Scotland Plc* on the grounds that MiFID does not prescribe the enforcement mechanism to be used by member states.⁴¹ This result is arguably the correct result as an interpretation of the current law, but is not ideal as a matter of policy.

Obligations owed

³³ COBS 3.5.2.

³⁴ COBS 3.4. Unless they establish a case of being an 'elective professional client' under COBS 3.5.3.

³⁵ See, G McMeel, 'The Impact of Exemption Clauses and Disclaimers: Construction, Contractual Estoppel and Public Policy', in A Dyson, J Goudkamp and F Wilmot-Smith (eds), *Defences in Contract* (2017) 239.

³⁶ See <https://www.fca.org.uk/consumers/interest-rate-hedging-products>.

³⁷ Ibid.

³⁸ Department for Business, Innovation and Skills, *Protection of Small Businesses when Purchasing Goods and Services: Government Response to the Call for Evidence*, February 2016.

³⁹ Financial Conduct Authority Handbook, Dispute Resolution: Complaints (DISP) 2.7.3.

⁴⁰ COBS 3.5.2.

⁴¹ [2012] CSOH 133.

As has already been said, COBS enacts a wide range of obligations which are capable of giving rise to a damages remedy under s 138D(2). These range across such matters as ensuring that recommendations of investments are 'suitable' for the client,⁴² acting in the client's best interests,⁴³ communications with clients,⁴⁴ financial promotions,⁴⁵ and record keeping.⁴⁶

These provisions are supported by a widely worded ban on attempts to exclude or restrict their operation.

COBS 2.1.2R states that:

A firm must not, in any communication relating to designated investment business seek to:

- (1) exclude or restrict; or
- (2) rely on any exclusion or restriction of;

any duty or liability it may have to a client under the regulatory system.⁴⁷

For the purposes of this article, I propose to concentrate on those areas which have been at the forefront of litigation brought under s 138D(2): the 'best interests' rule; failing to give a customer proper information about the characteristics of and the risks inherent in a product and recommending a product which is unsuitable for a customer.

Best interests

COBS 2.1 establishes the client's 'best interests' rule.⁴⁸ COBS 2.1.1R(1), breach of which is actionable in tort, states that:

A firm must act honestly, fairly and professionally in accordance with the best interests of its client.⁴⁹

Although this rule is widely worded, it leaves a claimant with a substantial burden of proof in having to prove dishonesty, unfairness or a lack of professionalism.

The rule applies only to 'designated investment business'⁵⁰ As a result, it does not apply to a bank which sells a savings account or a mortgage to a customer. There is therefore no obligation on a bank, for example, to advise a customer that a better rate of interest could be obtained from a rival firm. *Caveat emptor* is not overridden in such circumstances.

This rule has been little used. In *MTR Bailey Trading Limited v Barclays Bank plc*⁵¹ it was argued that a bank had breached it by requiring a customer to transfer a disadvantageous swaps contract to an associated company. At first instance, HH Judge

⁴² COBS 9.2R. *Zaki v Credit Suisse (UK) Limited* [2013] EWCA Civ 14, *Rubenstein v HSBC Bank PLC* [2012] EWCA Civ 1184.

⁴³ COBS 2.1R.

⁴⁴ COBS 2.2.1R. *Rubenstein v HSBC Bank PLC* [2012] EWCA Civ 1184.

⁴⁵ COBS 4.3R.

⁴⁶ COBS 3.8R. *Rubenstein v HSBC Bank PLC* [2012] EWCA Civ 1184.

⁴⁷ See further McMeel (supra n 34).

⁴⁸ Implementing Article 19(1) of MiFID and Article 14(1)(a) and (b) of the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive, European Parliament and Council Directive 2009/65/EC OJ 2009 L 302/32.

⁴⁹ In relation to MiFID business it protects all clients. For non-MiFID business only retail clients are protected.

⁵⁰ COBS 1.1.1R(2).

⁵¹ [2014] EWHC 2882 (QB).

Keyser QC held that a mere mistake by a bank as to its contractual rights would not constitute a lack of professionalism, honesty and fairness such as would establish a breach of the best interests rule.⁵² However, the Court of Appeal subsequently permitted the claimant to appeal this decision on the grounds that the company's claim was arguable.⁵³ It is submitted that the interpretation given at first instance is correct.

Provision of information

A number of important rules govern the information which must be given to a client. Under the terms of s 138D(2) breach of these rules is actionable by a private person if they have suffered loss as a consequence of the breach.

Information disclosure before providing services

COBS 2.2.1R provides for the information which must be disclosed before services are provided to a client.

- (1) A firm must provide appropriate information in a comprehensible form to a client about:
 - (a) the firm and its services;
 - (b) designated investments and proposed investment strategies; including appropriate guidance on and warnings of the risks associated with investments in those designated investments or in respect of particular investment strategies;
 - (c) execution venues; and
 - (d) costs and associated charges;so that the client is reasonably able to understand the nature and risks of the service and of the specific type of designated investment that is being offered and, consequently, to take investment decisions on an informed basis.
- (2) That information may be provided in a standardised format.

This is a positive obligation to provide general information which goes considerably further than the equivalent common law obligation not to provide misleading information.⁵⁴ The rule does not simply create a formal obligation to provide information as to the firm and its charges. It goes further because of the obligation to provide information as to the risks inherent in the designated investments or the investment strategy being proposed. On the other hand, such introductory information can be supplied in a standardised form and an adviser who supplies appropriate information is entitled to assume that an intelligent and educated client will read and understand it.⁵⁵

Communications with clients

Once the client relationship is established, more detailed rules need to be satisfied. Of central importance is the 'fair, clear and not misleading' rule laid down by COBS 4.2.1R:

- (1) A firm must ensure that a communication or a financial promotion is fair, clear and not misleading.
- (2) This rule applies in relation to:
 - (a) a communication by the firm to a client in relation to designated investment business other than a third party prospectus;
 - (b) a financial promotion communicated by the firm that is not:

⁵² [2014] EWHC 2882 (QB).

⁵³ [2015] EWCA Civ 667.

⁵⁴ *Green & Rowley v The Royal Bank of Scotland plc* [2013] EWCA Civ 1197, para 17.

⁵⁵ *Al Sulaiman v Credit Suisse Securities (Europe) Ltd* [2013] EWHC 400, para 154.

- (i) an excluded communication;
- (ii) a non-retail communication;
- (iii) a third party prospectus; and
- (c) a financial promotion approved by the firm.

This rule does more than simply require provision of information and warnings as to risks. The requirement to ensure that information is not 'misleading' effectively creates a statutory remedy for misrepresentation. In *Rubenstein v HSBC Bank PLC*⁵⁶ it was held that advice that an investment was as 'safe as cash' when it was actually equity based was actionable.⁵⁷ An equivalent provision in the Insurance Conduct of Business sourcebook (ICOB)⁵⁸ was held to have been infringed in *Figurasin v Central Capital Ltd*⁵⁹ when a sales person failed to make clear to a prospective client that the sum quoted as the cost of a loan included a substantial PPI premium. Guidance contained in COBS 4.2.2G is to the effect that the rule should be applied proportionately with the result that more may be expected in a communication to a retail client than in one to a professional one.

In contrast with COBS 2.2.1R, tort claims brought for a breach of COBS 4.2.1R are dependent on proof of negligence as a firm has a defence if reasonable steps have been taken to ensure compliance. COBS 4.2.6 provides:

If, in relation to a particular communication or financial promotion, a firm takes reasonable steps to ensure it complies with the fair, clear and not misleading rule, a contravention of that rule does not give rise to a right of action under s 138D(2) of the Act.

A further anti-misrepresentation provision operates in relation to information concerning investment business that is likely to be received by a retail client.⁶⁰ This is an example of an increased level of protection being given to retail, but not professional clients. The provision aims to ensure that a retail customer is given a balanced picture of the advantages and possible risks of a proposed investment. COBS 4.5.2R provides that:

A firm must ensure that information:

- (1) includes the name of the firm;
- (2) is accurate and in particular does not emphasise any potential benefits of relevant business or a relevant investment without also giving a fair and prominent indication of any relevant risks;
- (3) is sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received; and
- (4) does not disguise, diminish or obscure important items, statements or warnings.

Given that the wording of this rule is drafted in terms designed to ensure that balanced information is provided to a retail customer, it is not surprising that it is not qualified by

⁵⁶ [2011] EWHC 2304 (QB). Per HH Judge Havelock-Allen QC. This finding, which was based on the older version of the rule (COB 2.1.3R) was not appealed.

⁵⁷ Cf *Worthing v Lloyds Bank plc* [2015] EWHC 2836, para 63.

⁵⁸ Financial Conduct Authority Handbook, Insurance: Conduct of Business, ICOB 2.2.3(1)R. The current provision is Financial Conduct Authority Handbook, Insurance: Conduct of Business Sourcebook (ICOB) 2.2.2R.

⁵⁹ [2014] EWCA Civ 504.

⁶⁰ Defined by COBS 3.4.1R as a 'retail client is a client who is not a professional client or an eligible counterparty.'

a criterion of reasonableness. There are supplementary rules concerning the provision of information comparing products and businesses⁶¹ and the tax treatment of products.⁶²

Suitability

In terms of litigation the most commonly invoked rights created by the FCA Handbook are those contained within chapter 9.2 of COBS. These place a 'suitability' requirement on a firm which makes a personal recommendation in relation to a designated investment⁶³ and on a firm which manages investments on behalf of clients.⁶⁴ For these purposes 'recommendation' is defined as 'advice on investments.'⁶⁵ The rule therefore relies upon the distinction between advisory work and non-advised sales which is central to this area of law.⁶⁶ A sale of a product which is not based on an advisory or management function is not subject to the suitability requirement. Neither is general advice as to the investment, tax or estate planning strategy to be pursued, unless specific products are recommended.⁶⁷ Such transactions will be governed by principles of *caveat emptor* and the general law of negligence. This distinction is of particular importance for banks as they commonly offer both kinds of service to their customers.⁶⁸ In *Rubenstein v HSBC Bank plc*⁶⁹ a banker mistakenly thought that he was not performing an advisory role and therefore did not undertake a customer fact find.

However, his assumption was held to have been mistaken and the failure resulted in the client acquiring an unsuitable product for which the bank was held liable. The distinction is also important because retail banks have started to offer private customers online investment platforms on a non-advisory basis.⁷⁰ The suitability requirement will not apply to investment products purchased in this way.

Alleged breaches of this requirement have been the basis of the majority of reported cases brought under s 138D(2).⁷¹ COBS 9.2.1R⁷² provides:

⁶¹ COBS 4.5.6R.

⁶² COBS 4.5.7R.

⁶³ COBS 9.1.1R. See also the equivalent provisions in Financial Conduct Authority Handbook, Insurance: Conduct of Business Sourcebook (ICOBS) 5.3.1R (Insurance) and Financial Conduct Authority Handbook, Mortgages and Home Finance: Conduct of Business Sourcebook (MCOB) 4.7A.2R (Mortgage advice).

⁶⁴ COBS 9.1.3R.

⁶⁵ Financial Conduct Authority Handbook, Consumer Redress Schemes Sourcebook, Appendix (CONRED APP) 1.1. The distinction between giving advice and giving information is set out in Financial Conduct Authority Handbook, The Perimeter Guidance Manual (PERG) 2.7.15G.

⁶⁶ In the context of negligence, see *JP Morgan Chase Bank v Springwell Navigation Corporation* [2008] EWHC 1186 (Comm) para 108, per Gloster J.

⁶⁷ See, generally, PERG 2.7.15G.

⁶⁸ Negotiations between bank and customer can lead to it being unclear whether staff were simply giving information or were advising the customer. The response of banks has been to use contractual terms which state explicitly that advice has not been given and that customers should seek independent advice if they have concerns about the transaction they are entering. In practice, such terms have tended to be effective. The normal approach, as seen in *Crestsign Ltd v National Westminster Bank PLC* [2014] EWHC 3043 is to regard such terms as a 'basis' clause: ie as a term which determines the scope of the bank's contractual obligation. In the alternative, when the term has been classified as an exclusion clause it may well satisfy the Unfair Contract Terms Act 1977 because it is held to be reasonable between the parties. *Titan Steel Wheels Limited v The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm). The finding was obiter as the terms were held to have been a basis clause. See generally, G McMeel, ante n 35.

⁶⁹ [2013] PNLR 9.

⁷⁰ See: for Barclays Bank <https://www.smartinvestor.barclays.co.uk/important-information/what-is-barclays-smart-investor.html>; for NatWest <http://www.natwest.com/personal/investments/g2/self-select.ashx>

⁷¹ And the predecessor provisions. See ante n 1.

⁷² Implementing Article 19(4) of MiFID and Article 12(2) of the Insurance Mediation Directive, 2002/92/EC.

- (1) A firm must take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.
- (2) When making the personal recommendation or managing his investments, the firm must obtain the necessary information regarding the client's:
 - (a) knowledge and experience in the investment field relevant to the specific type of designated investment or service;
 - (b) financial situation; and
 - (c) investment objectives;
 so as to enable the firm to make the recommendation, or take the decision, which is suitable for him.

The effect of the provision should be noted. The required result is the purchase or sale of a product which is 'suitable.' If the advice given relates to a portfolio of investments, lack of diversity or high levels of leverage may establish unsuitability.⁷³ The provision thus establishes a strict liability result: one which is unqualified by any criterion of negligence and which turns on the result achieved rather than the means employed to achieve the result.⁷⁴ In *Zaki v Credit Suisse (UK) Ltd*⁷⁵ it was accepted that no actionable breach of this requirement would be established if a suitable product was recommended, even if procedural failings had occurred in the process leading to that recommendation.⁷⁶

The suitability of a product for a customer's needs can only be judged in the light of a fact find relating to that customer. In the words of Rix LJ 'It may not be easy to give suitable advice: but it is harder to do so if one goes about it in the wrong way.'⁷⁷ Rule 9.2.2R⁷⁸ makes it a requirement that such a fact find be conducted.⁷⁹

- (1) A firm must obtain from the client such information as is necessary for the firm to understand the essential facts about him and have a reasonable basis for believing, giving due consideration to the nature and extent⁸⁰ of the service provided, that the specific transaction to be recommended, or entered into in the course of managing:
 - (a) meets his investment objectives;
 - (b) is such that he is able financially to bear any related investment risks consistent with his investment objectives; and
 - (c) is such that he has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.
- (2) The information regarding the investment objectives of a client must include, where relevant, information on the length of time for which he wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment.

⁷³ *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14, para 129.

⁷⁴ Although it is not spelt out in the same way, this would appear to be a straight equivalent of the 'consumer expectation' test which governs the definition of 'defect' in s 3 of the Consumer Protection Act 1987.

⁷⁵ [2013] EWCA Civ 14, para 99. See also, *Basra Al Sulaiman v Credit Suisse Securities (Europe) Limited* [2013] EWHC 400 (Comm) para 19.

⁷⁶ But, those procedural failings might be actionable as a breach of the rules concerning provision of information or the customer fact find.

⁷⁷ *Rubenstein v HSBC Bank plc* [2013] PNL R 9, para 59.

⁷⁸ Implementing Articles 35(1), (3) and (4) of the MiFID implementing Directive.

⁷⁹ A failure to conduct such a fact find, resulting from a misapprehension that no advice was being given, was the basis of the finding of liability in *Rubenstein v HSBC Bank plc* [2013] PNL R 9.

⁸⁰ Excessive leverage may render a loan transaction 'unsuitable.' *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14, para 89.

(3) The information regarding the financial situation of a client must include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments.

The obligation on the adviser under this provision is to obtain those facts which establish: a reasonable basis for believing that the transaction meets the client's objectives; that the client has sufficient assets to bear any risks created by the investment and sufficient understanding to appreciate those risks. The unsuccessful claim in *Basra Al Sulaiman v Credit Suisse Securities (Europe) Limited*⁸¹ was based on an allegation that the claimant had not been given a sufficient understanding of the risks involved in purchasing and trading in leveraged structured notes.

COBS 9.2.3R⁸² further provides that:

The information regarding a client's knowledge and experience in the investment field includes, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved, information on:

- (1) the types of service, transaction and designated investment with which the client is familiar;
- (2) the nature, volume, frequency of the client's transactions in designated investments and the period over which they have been carried out;
- (3) the level of education, profession or relevant former profession of the client.

Viewed as a piece of consumer protection legislation, the tort which emerges from these rules is a close relation to the implied terms of quality incorporated by statute into a sale of goods contract.⁸³ Given the sums of money which may be involved in the sale of investments, pensions and insurance, it is not surprising that claims under these provisions are now a familiar part of modern tort law. The leading case of *Rubenstein v HSBC Bank plc*⁸⁴ is an example of liability based (inter alia) on a recommendation of an unsuitable investment given the client's attitude to risk⁸⁵ and on a failure by the adviser to conduct a fact find. The claimant had wanted an investment equivalent to cash as the money being invested was the proceeds of a house sale that was intended to be used to purchase a new property. The product sold in fact exposed the claimant to market movements and proved illiquid for a period during the 2008 crisis before it was finally sold at a loss. In that case the failure to achieve suitability seems to have been based on the availability of a less risky product which was more suitable given the client's clearly stated risk aversion in relation to this transaction.⁸⁶ The older case of *Seymour v Ockwell*⁸⁷ is a similar example, decided under s 62 of the Financial Services Act 1986, of a high risk and unsuitable product being recommended to customers who wanted no or minimal risk. In both cases, liability was established both at common law in negligence and under the statute.

However, the simple fact that an investment can be shown, with the benefits of hindsight, to have been a bad one does not necessarily mean that it was unsuitable at the time that it was made. Cases such as *Zaki v Credit Suisse (UK) Ltd*⁸⁸ illustrate that

⁸¹ [2013] EWHC 400 (Comm).

⁸² Implementing Article 37(1) of the MiFID Implementing Directive.

⁸³ Sections 9 and 10 of the Consumer Rights Act 2015.

⁸⁴ [2013] PNL 9.

⁸⁵ It was a 'packaged' product and was not the most suitable one available to satisfy the client's needs under the former COB 5.3.5R. An equivalent rule does not exist in COBS.

⁸⁶ For more detail see [2013] PNL 9, para 55.

⁸⁷ [2005] PNL 39.

⁸⁸ [2013] EWCA Civ 14, para 99.

high risk investments may be suitable for high net worth investors who understand the market and the risks they are taking in seeking high returns. Such a result occurred in *O'Hare v Coutts & Co.*⁸⁹ The client in that case was a very high net worth individual who was investing the proceeds of the sale of a business and who could afford to take risks in seeking a high return by means of wealth generation products. The client had received a full explanation as to the risks involved in the investment in question. Kerr J held that in these circumstances the investment was not unsuitable.

The law in this area needs to strike a balance between the protection of those acquiring financial products and the expectation that such persons take responsibility for their own decisions.⁹⁰ This is an area which features a classic professional scenario. The customer's actions and decisions are guided by the expertise of the advisor. That expertise may well lead the customer into buying products of which they had not previously had knowledge and of which they have little detailed understanding.

The Financial Services and Markets Act 2000, when setting out the objectives of the FCA, recognises the conflicting policies. Section 1C provides:

- (1) The consumer protection objective is: securing an appropriate degree of protection for consumers.
- (2) In considering what degree of protection for consumers may be appropriate, the FCA must have regard to—
 - (a) the differing degrees of risk involved in different kinds of investment or other transaction;
 - (b) the differing degrees of experience and expertise that different consumers may have;
 - (c) the needs that consumers may have for the timely provision of information and advice that is accurate and fit for purpose;
 - (d) the general principle that consumers should take responsibility for their decisions;
 - (e) the general principle that those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question;
 - (f) the differing expectations that consumers may have in relation to different kinds of investment or other transaction;
 - (g) ...

The FCA's statutory objectives thus expressly recognise that a balance needs to be struck between the need to protect consumers and their taking responsibility for their own decisions.⁹¹ Financial markets can be volatile. Investments can lose value even though they were suitable for the customer's needs when acquired. To succeed in a claim under s 138D(2) a claimant must prove that the advice given was unsuitable at the time it was offered. Cases such as *O'Hare* support the contention that it is acceptable for a bank offering advice to induce a customer to purchase one of its products as long as that sale satisfies the 'suitability' criterion.⁹² It was there accepted that it is the role of a bank to sell products to customers and that there is nothing intrinsically wrong in

⁸⁹ [2016] EWHC 2224 (QB). Also *Al Sulaiman v Credit Suisse Securities (Europe) Ltd* [2013] EWHC 400.

⁹⁰ See the views of Rix LJ in *Rubenstein v HSBC Bank* [2013] PNLR 9, at paragraph 115 and *Zaki v Crédit Suisse (UK) Ltd* [2013] EWCA Civ 14 at para 83.

⁹¹ The claims made in a number of leading cases failed on the grounds that the investor was willing to take risks in pursuit of a high return: eg *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14 and *Al Sulaiman v Credit Suisse Securities (Europe) Ltd* [2013] EWHC 400.

⁹² Kerr J (para 217) uses the criterion of 'foolhardy' to indicate when the line is overstepped. It is submitted that this cannot be correct.

using sales techniques to achieve that result. It is the suitability test which governs whether the sale was wrongful. Furthermore, advisers are employed to give the client the benefit of their expertise. It may be perfectly proper for an adviser to advise the client to invest in a form of product which had not been previously considered. An adviser's role may be to tutor the client on investment opportunities which are suitable. The fact that they prove with hindsight not to have performed as expected does not mean that the advice was unsuitable when given. As Kerr J said in *O'Hare*:

In my judgment, the authorities do not exclude the proposition that in an appropriate case, advice from a private banker may condition the client's risk appetite, rather than the other way round⁹³

and (in greater detail)

a private banker may have a client whose untutored risk appetite (at a time of very low interest rates for cash investments) is so risk-averse that he would lose out on a bonanza of high returns unless advised about the virtues of equities during a time of sharply rising share prices. In principle, an adviser who failed to advise the client to take more risk than he had hitherto taken, might even be negligent.⁹⁴

Advice means what it says. The role is to provide the client with information on which a decision can be made. It is not to make the decision for the client. Although the FCA rules create an obligation to review the customer's affairs and attitude, so that the capacity and appetite for risk can be assessed and used when recommendations are made, it is ultimately for the client to make decisions based on the information put before them. An investment adviser's role is not that of an insurer against investments proving mistaken.

Appropriateness (Complex instruments)

Whereas COBS 9 creates the 'suitability' duty when financial products have been recommended or where clients' investments are being managed, COBS 10, which is also derived from MiFID,⁹⁵ creates a different level of duty when 'complex products'⁹⁶ have been chosen by a person who has received no advice or recommendation. The aim of this provision is to create a level of protection for purchasers of products such as derivatives, options or swaps. Purchases of shares, bonds and unit trusts are specifically excluded from this protection. In a case falling within COBS 10, the firm conducting the trade is required to consider whether the purchase is 'appropriate' for the client⁹⁷ and to warn if they believe that this is not the case.⁹⁸ The 'appropriate' criterion requires the firm merely to inquire as to the client's experience and knowledge of the form of investment being purchased.⁹⁹ COBS 10 is thus significantly less demanding than the 'know your customer' obligations imposed by COBS 9 in the case of advised sales as there is no need to inquire into the client's means or investment objectives.

Best execution

⁹³ Para 218.

⁹⁴ Para 220.

⁹⁵ Article 19(5) of MiFID and Article 36 of the MiFID Implementing Directive.

⁹⁶ Defined by COBS 10.4.

⁹⁷ COBS 10.2.1R. For exceptions to this see COBS 10.4.

⁹⁸ COBS 10.3.1R. The client must also be warned if the required information is not supplied that a decision as to appropriateness will not be possible COBS 10.3.2R.

⁹⁹ COBS 10.2.2R.

A further rule¹⁰⁰ which has some potential of giving rise to a tort claim is the 'best execution' rule found in COBS 11. This applies to 'execution only' dealings in non complex products, ie those where the decision to trade and what to trade is made by the client in the absence of any advice. Because the operation of COBS 10 is confined to 'complex' financial instruments, such as derivatives, this is the only rule which applies to the recent development of online investment platforms without advisory services being offered by retail banks.¹⁰¹ Clients who purchase shares, or other 'non complex' financial products, in this way are in a 'caveat emptor' situation as long as the 'best execution' criterion is satisfied.

The obligation owed by a firm in such a case is contained in COBS 11.2.1R. It is that:

A firm must take all reasonable steps to obtain, when executing orders, the best possible result for its clients taking into account the execution factors.

It is clearly established that: 'the duty of best execution has to do with the mechanics of acquiring or selling securities, not the merits or otherwise of the trade.'¹⁰² It thus only concerns obtaining the best terms (eg the price) for the customer and says nothing about the suitability of the investment for that person's needs. Subject to this proviso, COBS 11.2.6R details the factors which are relevant to determining whether the 'best execution' standard has been achieved. They are: the characteristics of the client including the categorisation of the client as retail or professional; the characteristics of the client order; the characteristics of financial instruments that are the subject of that order and the characteristics of the execution venues to which that order can be directed. Client categorisation is particularly important here as there are examples recorded of banks attempting to exclude this obligation by use of contractual terms which deem the relationship to be one between two principals rather than between professional and client.¹⁰³ COBS 11.2.7R makes explicit provision that it is the total cost of a deal to a client (ie the price of the investment and the costs of executing the deal) which are to be considered in relation to the best execution criterion.

Causation and remoteness of damage

Section 138D(2) expressly make proof of damage an essential element in the cause of action which it creates for breach of a Handbook rule. Standard notions of causation therefore apply to the statutory tort. Thus in *Zaki v Credit Suisse (UK) Ltd*¹⁰⁴ it was held that some unsuitable investments had been made and that a breach of COBS 9.2.1R had been established. However, the Court of Appeal held that the client, who was a high net worth individual, was taking a bullish approach to the market and was determined to invest. On the balance of probabilities, the burden of proof being on the claimant to prove that reliance had been placed on the recommendation, he would still have made the investments had he been correctly advised that they were unsuitable. A classic 'but for' approach to factual causation thus excluded liability for an established breach.

*Rubenstein v HSBC bank plc*¹⁰⁵ raised a classic issue of remoteness of damage: to what extent does a professional obligation to a client raise a duty to protect that client from market movements? In that case the client had lost a significant sum of money on an investment at the time of the 2008 crash. The decision of the Court of Appeal was that

¹⁰⁰ Implementing Article 21(1) of MiFID and Article 25(2) first sentence of the UCITS implementing Directive.

¹⁰¹ See ante n 67.

¹⁰² *Första AP-fonden v Bank of New York Mellon SA/NV* [2013] EWHC 3127 (Comm) para 274, per Blair J.

¹⁰³ *Crestsign Ltd v National Westminster bank PLC* [2014] EWHC 3043, para 57.

¹⁰⁴ [2013] EWCA Civ 14, para 99.

¹⁰⁵ [2013] PNLR 9.

this sum was recoverable. The limits of this decision need to be appreciated. The case does not decide that a strict liability tort attracts a more generous regime of remoteness of damage. Indeed, the successful claim was based both on the statute and in negligence. The result, in line with that of the House of Lords in *South Australia Asset Management Corp v York Montague Ltd*,¹⁰⁶ was driven by the nature of the adviser's obligation. The client's stated desire for an investment equivalent to cash, motivated as it was by the fact that the money in issue represented the proceeds of a house sale which was intended to be invested in another property, meant that the client did not want to be exposed to the market. The defendant's breach resulted in the money being held in investments which exposed the client to market movements. The losses suffered as a result of the crash were thus of the very kind which the defendant was obliged to protect the client against.

The relationship of s 138D(2) to negligence

Because of the 'private person' threshold and limitations within the FCA rules many cases brought against investment advisers or banks are pleaded in negligence. In addition, private claimants may plead the torts in the alternative. It is therefore necessary to consider how the statutory scheme relates to contractual and tortious duties to take reasonable care.

Duty of care issues

The two torts exist independently of each other. However, it does not follow that the statutory tort is irrelevant to negligence claims.

The first question is whether negligence can fill gaps in the statutory protection. This is of particular importance for several reasons. First the private person threshold locks businesses out of the protection offered by the statutory tort. For a business the only cause of action will be in negligence. Secondly, because the extension to the limitation period enacted by s 14A of the Limitation Act 1980 only applies to claims brought in negligence and not to the statutory cause of action. As the value of an investment, such as a pension, may not be considered by an investor for some time after purchase, the non-availability of a secondary limitation period running from the date of the claimant's knowledge of damage may be an important reason for claiming in negligence.

The majority of cases in this area assume, without discussion, that the existence of and restrictions applicable to the statutory tort do not impact on a claim brought in negligence.¹⁰⁷ The leading English case is *Gorham v British Telecommunications plc*.¹⁰⁸ There the defendant pleaded that, as the then wording of s 62A of the Financial Services Act 1986¹⁰⁹ blocked the claimant from claiming under the statutory tort, there could be no claim in negligence. This argument was rejected. Pill LJ stated that 'the silence of the codes on the subject of the rights of beneficiaries does not exclude the power of the court to consider whether a duty of care exists.'¹¹⁰ It follows directly from *Gorham* that a negligence claim will not be barred simply because the claimant is outside the definition of 'private person' under the ROA regulations.¹¹¹ There is thus an alternative common law cause of action available to businesses which is not subject to those restrictions. This is important because the Handbook imposes a significant number of

¹⁰⁶ [1997] AC 191.

¹⁰⁷ *Camerata Property Inc v Credit Suisse Securities (Europe) Ltd* [2012] EWHC 7; *Crestsign Ltd v National Westminster Bank PLC* [2014] EWHC 3043.

¹⁰⁸ [2000] 1 WLR 2129.

¹⁰⁹ That wording made it a precondition that the claimant was a 'private investor.' The claimant was the spouse of the investor and beneficiary of the pension rights at issue.

¹¹⁰ See also the industrial injury case of *Bux v Slough Metals Ltd* [1973] 1 WLR 1358.

¹¹¹ Ante p xx.

rules on advisers dealing with businesses. These rules may well supply content as to what a reasonable adviser should do when dealing with a non-private person.

However, Lord Hodge in the Outer House of the Court of Session in *Grant Estates Ltd v Royal Bank of Scotland PLC*,¹¹² a case alleging that a bank has mis-sold an interest rate swap, adopted a radically different approach which effectively held that the constraints placed by Parliament on the statutory tort created a policy limitation on any duty of care.

I do not think that GEL can rely on the COBS rules to create a common law duty of care in relation to the provision of advice. A common law duty can arise from the existence of a statutory duty as part of the background circumstances; and the existence of a statutory duty may show that a particular risk should have been foreseen. When the court assesses the effect of the statutory duty on the question whether it is just and equitable to impose a duty of care the primary consideration is, in my view, the policy of the statute. Looking to the policy of the FSMA one discovers that it provides protection to consumers of financial services through a self-contained regulatory code and statutory remedies for breach of its rules. As I have said, it needs no fortification by the parallel creation of common law duties and remedies. Further, the existence of a duty in negligence for failure to comply with the COBS rules would circumvent the statutory restriction on the direct right of action...

This statement is obiter. The actual result in *Grant Estates* was based on a finding that express terms in the contract between the parties precluded the pursuer from basing a claim on either an implied contractual term or on negligence. However, Lord Hodge's approach does seem to conflict with *Gorham*. Indeed, it may be questioned why duty of care methodology was invoked. The facts of the case presented a standard example of advice given to a client in a precontractual situation. It thus raised a standard issue of misrepresentation and of the *Hedley Byrne v Heller* duty and the extent to which such duties can be negated by contractual terms. Whereas it may appear logical to ask whether a novel duty of care should be recognised which extends beyond a statutory scheme, it makes much less sense to block a recognised head of duty of care to reflect limitations in a parallel statutory scheme. On that basis, it is submitted that *Gorham* is correct: *Grant* is correct on its facts (because of the contractual terms) but the dictum on the tort duty is wrong.

A different, but related, point was at issue in *Green & Rowley v the Royal Bank of Scotland plc*.¹¹³ In that case, the statutory duty in issue was the positive one to provide information¹¹⁴ which has no common law equivalent (the *Hedley Byrne* duty being limited to not providing misleading information). In those circumstances the Court of Appeal roundly rejected a contention that breach of the statutory duty raised an equivalent common law one. The form of a concurrent common law duty must therefore be one which the common law recognises before limits within the statutory scheme can be overcome by resort to negligence. That was the case in *Gorham* where the insurance company gave negligent advice about the claimant's husband's pension arrangements. A successful claim in *Green & Rowley* would have taken the *Hedley Byrne* duty of care into a wholly new field (that of a positive obligation to provide information). In the words of Tomlinson LJ:

The existence of a statutory duty may give rise to a common law duty of care in circumstances where breach of the statutory duty is not actionable in private law. The more usual case is where in performance of a statutory duty a party ... brings about a relationship between itself and another person such as is recognised to give rise to a duty of care owed to that person. Again, the duties are not co-

¹¹² [2012] CSOH 133.

¹¹³ [2013] EWCA Civ 1197.

¹¹⁴ COB 2.1.3R and 5.4 3R.

extensive and the duty at common law does not arise by reason of the imposition of the statutory duty but arises out of the relationship so created.¹¹⁵

'Crystallising' the standard of care

There is widespread support for the argument that the content of the statutory duty 'crystallises or concretises'¹¹⁶ the common law one. In short, it is a failure of reasonable skill and care to fail to comply with the requirements which the statute imposes on you (a reasonable person obeys the law). As a result, the issues raised in a claim brought in negligence are likely to be identical to those raised in a statutory claim. The provisions contained in the FCA Handbook determine what amounts to taking reasonable care of a client's interests. Rix LJ has stated this approach as follows:

It would seem therefore that, at any rate in the context where the COB rules apply to investment advice provided to a private person, the applicable principles in contract and/or tort will be guided by the focus and purpose of the statutory provisions.¹¹⁷

In *Crestsign Ltd v National Westminster Bank PLC* Deputy Judge Tim Kerr QC adopted a similar approach saying:

I agree with the banks that the two sets of duties are not to be treated as co-terminous and that breach of a COBS duty is not necessarily common law negligence.

But it does not follow that breaches of COBS duties (not actionable as such at the suit of Crestsign) cannot also be negligent at common law. Nor is the content of the COBS duties wholly irrelevant in a common law claim brought by a person unable by statute to sue for breach of a COBS duty. The COBS duties are likely to be relevant to determining the standard of care required of a reasonably careful and skilled adviser, since a reasonably skilled and careful adviser would not fall short of the standard required to meet relevant regulatory requirements.¹¹⁸

At times, this result is assumed without discussion. Thus in *O'Hare v Coutts & Co*¹¹⁹ the statutory suitability standard is stated by Kerr J as defining a common law obligation to show reasonable skill and care.

It is common ground that the contract included an implied duty, and the law of tort imposed an identical duty, to use reasonable skill and care when recommending investments. In the financial context, this is often paraphrased by saying that the recommended investments must be 'suitable'.

The Bolam principle

¹¹⁵ Ibid para 29.

¹¹⁶ Terms first used by G Williams, 'The Effect of Penal Legislation in the Law of Tort' (1960) 23 MLR 233, 234 in relation to the analogous area of industrial safety legislation in which torts based on negligence and breach of statutory duty used to coexist.

¹¹⁷ *Rubenstein v HSBC Bank plc* [2013] PNLR 9, para 46. See also *Al Sulaiman v Credit Suisse Securities (Europe) Ltd* [2013] EWHC 400, para 18 per Cooke J.

¹¹⁸ [2014] EWHC 3043, paras 126-7. See also para 146. 'I resist the fallacious reasoning that because common law duties and COBS duties are not co-terminous, and because Crestsign is excluded from the class of persons able to sue for breach of COBS duties, the banks can owe no common law duty which happens to overlap with a COBS duty.'

¹¹⁹ [2016] EWHC 2224 (QB).

The role of negligence in this context inevitably raises the role of the *Bolam* principle¹²⁰ which tests professional conduct by the standards adopted by bodies of reasonable practitioners of the skill.

The first thing to say is that a standard of accepted practice is a difficult concept to apply in relation to recommendations to purchase particular financial products. It is possible that a responsible body of practitioners exists somewhere that would recommend virtually any product. If this is correct, the test will operate in a way which will favour defendants. For example, recent litigation on interest rate hedging products shows a widespread assumption within the industry that interest rates would rise in the post 2008 period and that customers should buy protection against that risk. Hindsight tells us that this view was seriously mistaken and that interest rates would fall to historically low levels. However, it is difficult to see how an adviser could be held to have infringed *Bolam* by recommending that the client buy protection. Indeed, all of the cases seem to rely on more technical failings (such as failures to spell out in detail the financial consequences of terminating such a contract if interest rates fell). In short, the *Bolam* test is more likely to be appropriate in relation to more mechanical matters such as conducting a fact find on the client.

A separate question is the extent to which the common law in relation to the giving of advice is abandoning the *Bolam* test. It is well known that the Supreme Court decision in *Montgomery v Lanarkshire Health Board*¹²¹ has changed the position in relation to advice given regarding risks created by medical treatment. Lord Kerr there defined a doctor's duty of reasonable care in relation to information as: 'a duty ... to take reasonable care to ensure that a patient is aware of material risks of injury that are inherent in treatment.'¹²² This is a duty free from any consideration of the different approaches of different groups of reasonable doctors. 'The test of materiality is whether, in the circumstances ..., a reasonable person in the patient's position would be likely to attach significance to the risk, or the doctor is or should reasonably be aware that the particular patient would be likely to attach significance to it.'¹²³ The doctor's role involves a dialogue with the patient in order to ensure that the position and the alternatives are understood.¹²⁴

The question is whether this approach, being based on principles of self determination, is confined to the medical context or is more widely applicable to situations of advisory work, particularly those concerning risks created by particular financial products. Expressed differently, does a development in the law concerning rights to determine what is done to a person's body effect the explanation of risks when economic interests are at stake?

While it is clear that the decision in *Montgomery* is expressed in terms which concern only medical practice, courts have begun to extend it further. In *Baird v Hastings*¹²⁵ the Northern Ireland Court of Appeal expressly applied *Montgomery* in a claim against a solicitor asserting a negligent failure to advise clients as to the consequences of their failing to complete a sale of their property. The court emphasised that the solicitor was bound to take reasonable care to ensure that the client understood the material legal risks created by the transaction.

¹²⁰ *Bolam v Friern HMC* [1957] 1 WLR 582.

¹²¹ [2015] AC 1430.

¹²² *Ibid* para 82.

¹²³ *Ibid* para 87.

¹²⁴ *Ibid* para 90.

¹²⁵ [2015] NICA 22.

The most important decision in the financial services context is that of Kerr J in *O'Hare v Coutts & Co*¹²⁶. The judge in that case emphasised the need for a dialogue between adviser and client and expressly refused to apply the *Bolam* approach. However, he relied upon detailed rules¹²⁷ in the FCA Handbook concerning the giving of information to a client as effectively leading to the same result as would have been achieved by *Montgomery*. The judge argued that these rules lay down a detailed scheme for the provision of information to clients which is incompatible with *Bolam*: there was no room within the scheme for the recognition of different bodies of reasonable opinion. The result is that the Handbook rules determine the question of what information is to be given to a client by a financial adviser irrespective of whether a claim is brought in negligence or for breach of the rules under s 138D(2).¹²⁸ If this approach is followed it will represent an important development in professional negligence law in the investment advice area.

Conclusion

The s 138D(2) tort has spawned an important and distinctive area of professional liability, albeit one that seems to be of most importance to high net worth individuals.

One fears that the pensions freedoms introduced in recent years will give rise to a further body of claims alleging mis-selling. The tort deserves to receive greater attention. It plays an important consumer protection role both in itself and in influencing accepted practice and thus how negligence applies to investment advisers.

The law on this subject is not user friendly. A litigant in person will find it almost impossible to understand based, as it is, on the heavily amended FSMA and the complex FCA Handbook. There appears to be little online guidance available.¹²⁹ The Money Advice Service's website has a section on mis-selling of investments which touches on suitability but concentrates on the remedies provided by the FOS and the Financial Services Compensation Scheme.¹³⁰ Indeed, it issues a guarded warning against the risks of litigation. The law is problematic because the relationship between the concepts of 'private persons' and 'retail clients' cannot be understood without a knowledge of the way in which MiFID was grafted onto domestic law. For a business client, negligence remains the only real remedy. However, the private client has a possibly bewildering choice between the statutory tort, negligence and resort to the Ombudsman. There is also the possibility of the regulator removing the need for litigation by taking action which results in compensation being paid. Given this complexity and the sums of money which may be involved it is not difficult to see why this area is regarded as a growth area of professional liability law.

In terms of tort principle, this tort is one of a number of examples of statutory strict liability for pure economic loss. It provides part of an overall picture of the recovery of financial losses in tort alongside the 'economic' torts (for intentionally inflicted loss) and negligence. The picture is simply incomplete without this tort (and the similar one concerning breaches of competition law).¹³¹ The idea that tort baulks at the protection of financial interests is challenged by this tort. It is noteworthy that s 138D(2) has its origins in the mid 1980s when the common law was restricting recovery of pure

¹²⁶ [2016] EWHC 2224 (QB).

¹²⁷ The rules cited were COBS 2.2.1(1)R and 2.2.2(1)(b)R; 4.2.1(1)R; 9.2.1R, 9.2.2R, 9.2.3R and 9.2.6R.

¹²⁸ NB that this case is distinguishable from *Green & Rowley* (ante p xx) in that the negligence duty to provide advice was here based on an express contract.

¹²⁹ Although this position is alleviated to an extent by the fact that low value claims fall within the jurisdiction of the Financial Ombudsman Service which does provide high quality guidance for those considering complaining about the conduct of authorised firms.

¹³⁰ <https://www.moneyadvice.service.org.uk/en/articles/financial-mis-selling-what-to-do-if-you-think-its-affected-you#if-youve-been-mis-sold-a-financial-product>.

¹³¹ Ante, n 15.

economic loss in negligence at a time when the Thatcher government was liberalising financial markets and encouraging wider share ownership. A second challenge presented by the tort is to the idea propagated by scholars that strict tortious liability is imposed on activities which entail extraordinary risk to others.¹³² Section 138D(2) shows that in modern law such liability can serve a consumer protection role¹³³ alongside other contractually based strict liability remedies such as those concerning sale of goods. This role is far removed from the creation of extraordinary risks.

Given the extent to which the rules in the FCA's Handbook are derived from EU Directives such as MiFID, the future form of the tort, given Brexit, is uncertain. There are suggestions that the financial services industry will be looking for deregulation as a way forward if the city is excluded from the single market. However, if this is the case, notions of equivalence may become important and may force continued compliance with EU standards. It must be remembered that the basic form of this law was in place as domestic law before MiFID came into force. It may also be thought unlikely that the government would be keen to be seen to be loosening controls on the obligations owed by the financial services industry to clients given the recent history of mis-selling and other financial scandals. The likelihood is, therefore, that the s 138D(2) tort will survive and continue to grow in importance.

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¹³² *Fleming's The Law of Torts* (10th edn), C Sappideen and P Vines eds (2010) 380.

¹³³ As do the provisions of Part I of the Consumer Protection Act 1987.