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Briefing note 22 June 2012

Bank succeeds in defending claim for alleged mis-selling of structured products

The sanctity of the contractual agreement signed between consenting adults, and a bank's ability to limit its duties and obligations to execution-only services, has been upheld as a matter of contract law by the judgment of Reyes J. of the High Court ("the Court") handed down on 21 June 2012 in Kwok Wai Hing Selina v HSBC Private Bank (Suisse) SA HCCL 7 of 2010.

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Brief facts

Ms Kwok, ("the client") and the plaintiff in this case, opened a private banking account, an execution-only account, with HSBC Private Bank (Suisse) SA (the "Bank") in January 2003. Between January 2003 and December 2007 the client entered into some 350 Forward Accumulator ("FA") contracts with the Bank, together with investments in various other high-risk structured products, including Equity Linked Notes ("ELNs"). Over this time, the client's initial net worth with the Bank of US$12 million grew significantly, but by November 2007, when financial markets around the world plunged, her total exposure in both foreign and Hong Kong shares was around US$90 million and far exceeded her available assets. The client ultimately unwound the FAs and liquidated other products to cover her borrowings.

Key issues

- Claim for alleged mis-selling against bank dismissed
- Sanctity of contract affirmed
- Bank not required to monitor and forewarn client of risk

The Bank sold FAs as a structured product with a risk rating of 5 (being the highest level of risk assigned by the Bank). The Risk Disclosure Statement ("RDS") in the Account Opening Booklet (the "Booklet") provided to the client at the time she opened the account in January 2003 pointed out that "*The risk of loss in Trading Assets… can be substantial*". The RDS clearly set out that the Bank did not provide investment advice and that it is for the client to consider whether the investment is suitable to them (and to obtain independent professional advice if he/she was uncertain about an investment).

At trial, the client claimed almost US$10.5 million as the costs of unwinding her outstanding FAs. It was alleged that HSBC had breached its contractual or other obligations owed to the client. The client denied ever seeing the RDS, repeatedly claimed that she was "merely an unsophisticated housewife" (although she had attended university for a two year period) and that her completion of a signed copy of the Booklet required by the Bank, was, according to her, a "mere formality". The Bank accepted that it owed a number of duties to the client, including to act with due care, skill and diligence, to ensure that any advice it gave was not misleading and to notify and seek the client's consent before charging any assets in her account. The Bank denied that it owed any *additional* duties to advise the client and warn her of risks in relation to her account.

Findings

The Court held that:

- The client is (and was) perfectly capable of understanding the terms of the RDS;
- The client fully understood the mechanics of FAs and reached her own decisions on whether to invest in FAs (as evidenced by telephone recordings);
- The account held with the Bank was an "*execution-only*" account (i.e. it authorised the Bank to act in accordance with the client's instructions in relation to financial transactions) and that, as a matter of contract law, the client was bound by the terms of the contract; and
- The Bank did not owe any additional duties, nor could they be implied, to monitor the client's account and to warn her of her over-extension or over-exposure.

Key points to note

In addition to the findings set out above, the Court held that:

- a cautious approach ought to be adopted with regard to the oral testimony of each witness for the parties and their evidence was less reliable unless backed up by contemporaneous evidence, such as documents or telephone recordings between the Bank and the client;
- "call reports" (being file notes of meetings held with a client) were, similarly, to be approached with caution, as some were recorded days or even weeks after the relevant meeting with the client and could not be regarded as truly contemporaneous evidence;
- there were no implied duties owed by the bank to monitor the client's investments, manage the account or to forewarn the client they are over-extending;
- there was no implied negative duty owed by the Bank not to over-sell financial products;
- the Bank did not owe any contractual duty to perform regular "know-your-customer" ("KYC") updates;
- the sanctity of the contract had to be upheld as a matter of contract law;
- subsequent conduct of parties cannot be used to construe the terms of the initial contract;
- ultimately it is for the client to assess the suitability of a financial transaction (with or without recourse to independent advice);
- obligations are not to be implied into the contract where they would be contrary to the express terms of the agreement;
- when a client says they are too unsophisticated or too busy to look at the papers sent to them, that is their fault and their risk;
- not much assistance could be derived by the client in seeking to rely upon the regulatory standards set out in the Code for Conduct for Persons Licensed by or Registered with the Securities and Futures Commission (the "SFC Code"). The SFC Code cannot override express contractual provisions. It cannot impose duties which, by the clear terms of client account documentation, a bank has not undertaken;
- duties of care at common law do not assist the client in this case where there were express detailed contractual terms set out clearly in the Booklet and the RDS;
- the Unconscionable Contracts Ordinance (Cap 459) ("UCO"), whereby a Court may refuse to enforce terms of a contract if deemed to be unconscionable in relation to a client, did not apply here as there were no unconscionable terms of the contract agreement;
- where a client claims losses in respect of some contracts, one cannot look at those in isolation, but must look at the net of profits and losses made by client from the complete series of their investments.

Conclusion

Whilst each mis-selling case will fall to be determined on its own facts (and indeed the plaintiff may decide to appeal this judgment) it is reassuring that the Court relied on fundamental principles of contract law – namely that the parties are bound by their contractual agreement. Banks should therefore ensure that their account opening documents provide adequate disclosures as to the risks involved with certain investments and trading strategies, and , importantly, the relationship between the Bank and its customer.

The judgment also highlights the importance for Banks to record and retain contemporaneous evidence (such as telephone recordings) of the trading strategy and investment decisions agreed to by customers.

We await with interest the judgment in another accumulator case: DBS Bank (Hong Kong) Limited v San-Hot HK Industrial Company Limited and Hao Ting HCA 2779 of 2008, in which closing submissions are due to be heard before Deputy Judge Pow on 25 June 2012.

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