THOMSON REUTERS
PRACTICAL LAW™

Banks' duties when providing advice and information

by Anthony Pavlovich and Theodor van Sante, 3 Verulam Buildings (based on a note originally written by Richard Edwards QC)

Status: **Law stated date 13 March 2024** | Jurisdiction: **United Kingdom**

This document is published by Practical Law and can be found at: **uk.practicallaw.tr.com/w-029-1932**
Request a free trial and demonstration at: **uk.practicallaw.tr.com/about/freetrial**

This note provides an overview of when a bank may owe duties in respect of the provision to customers of advice or information about a proposed investment, business opportunity or other transaction. It also considers the circumstances in which a bank may owe duties under the FCA's rules in respect of advice provided to customers about a regulated investment, insurance or mortgage. It is one of a suite of notes on banks' duties.

The Practical Law team would like to extend our condolences to the family of Richard Edwards QC, who sadly passed away before the publication of the original version of this note. We would also like to thank his family for enabling us to publish the note and share his immense knowledge and expertise with our subscribers.

Scope of this note

Banks' duties in relation to advice and information often overlap with regulatory duties, which may offer greater protection for some customers. This note therefore addresses liability arising under the common law as well as under financial regulatory obligations. However, the ability to sue for regulatory breaches is restricted to a limited class and excludes the losses suffered by a company (as opposed to an individual) in the course of business. For more information, see Practice note, Claims for financial misselling under English law: Claims for breach of statutory duty.

The note is part of a suite of notes on banks' duties. The other notes are listed below:

- Practice note, Banks' duties when executing client instructions: the Quincecare duty.
- Practice note, Banks' duties when providing bank references and other information to third parties.
- Practice note, Banks' duties: fiduciary duties owed by banks.
- Practice note, Banks' duties: equitable duties owed by mortgagees when exercising a power of sale.

No general duty to advise

At a high level, a bank is not under a legal obligation to advise but if it gives advice it must do so using reasonable care and skill.

The essence of the law on this topic is contained in *Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465*, one of the most important cases in the law of negligence in the twentieth century. The House of Lords laid down as a general principle that:

> "if in a sphere in which a person is so placed that others could reasonably rely upon his judgment or his skill or upon his ability to make careful inquiry, a person takes it upon himself to give information or advice to ... another person who, as he knows or should know, will place reliance upon it, then a duty of care will arise." (Lord Morris of Borth-y-Gest at paragraphs 502-503)

Their Lordships confirmed that this principle applies to banks providing advice in the course of business to their customers, which approved Lord Finlay LC's statement in *Banbury v Bank of Montreal [1918] AC 626* that a banker "is under no obligation to advise, but if he takes upon himself to do so, he will incur liability if he does so negligently".

It is well established that banks do not generally owe a duty to:

- Advise their customers on the viability of the commercial projects for which they seek finance.
- Warn their customers of potential pitfalls of their projects.

For a bank to owe this duty, either:

- The customer must request advice and the bank must accept.

- The customer and the bank must agree to an arrangement under which the bank is to provide advice.

The duty will be contractual where the claimant can prove a contract under which the bank has agreed to advise. However, banks tend to characterise their interaction with clients as excluding advisory services in contracts. Often the claimant is left with establishing a tortious duty to advise on the part of the bank and such a duty arises in exceptional circumstances.

(*Lloyds Bank plc v Cobb (1991) 12 Legal Decisions Affecting Bankers 210 (CA)*, Scott LJ (see also *Williams & Glyn's Bank plc v Barnes [1981] Com LR 205*).)

One obvious reason for this is that unless the bank actually gives advice (at the customer's request or not), the customer cannot show that it was relying on the bank for that purpose. Another reason is that the bank and its customer tend to assess the merits of a transaction from different points of view. Therefore, in *National Commercial Bank (Jamaica) Ltd v Hew [2003] UKPC 51*, Lord Millett (in the Privy Council) observed:

> "It may well have been foolhardy of Mr Hew [the customer] to embark on the project without obtaining estimates of the likely costs and cash flow forecasts; but the bank was under no duty to advise him against such a course. It may have been unwise of Mr Cobham [the bank manager] to have lent the money without insisting on being provided with such estimates and forecasts and without having conducted a feasibility study of his own. But as Mr Cobham explained, any such study would have been for the Bank's protection, not Mr Hew's. The reason he did not call for such a study is that he did not think that the Bank's interests required it; the Bank had sufficient security to support a much larger loan than anything that was contemplated at the time. This is a useful illustration of the truism that the viability of a transaction may depend on the vantage point from which it is viewed; what is a viable loan may not be a viable borrowing. This is one reason why a borrower is not entitled to rely on the fact that the lender has chosen to lend him the money as evidence, still less as advice, that the lender thinks that the purpose for which the borrower intends to use it is sound."

The general proposition that banks owe no duty to advise their customers or to warn them of potential risks applies to most ordinary banking transactions, not only to lending. Even inherently risky transactions are not generally sufficient to give rise to a duty. For example:

- In *Redmond v Allied Irish Bank plc [1987] 2 FTLR 264*, the customer paid into his account endorsed, non-transferable cheques marked as payable only to the account of a third party. Savile J held that the bank had no duty to warn the customer of the dangers involved in this hazardous practice.
- In *Finch v Lloyds TSB Bank plc [2016] EWHC 1236 (QB)*, Judge Pelling QC held that a bank owed no duty to advise its customer as to the existence and effect of a particularly onerous term in the loan agreement that it was offering.

Regulatory position

This position is not altered under the financial regulatory system, save where a bank is selling a regulated mortgage contract (RMC).

Under MCOB 4.8A.7R, a bank is not permitted to enter into or arrange a sale of such contract without giving advice where either of the following apply:

- There is a spoken or other interactive dialogue between the bank and the customer at any point during the sale (subject to some limited exceptions in MCOB 4.8A.7AR).
- The customer is using a statutory "right to buy" option, or is raising funds for debt consolidation or the mortgage is a shared equity mortgage.

Guarantors

Generally, the same principles apply to guarantors. For example, the court held in *Barclays Bank plc v Khaira [1992] 1 WLR 623* that there is no duty to advise a potential guarantor to seek independent advice.

However, in exceptional circumstances, the bank may have a duty to disclose to a potential guarantor any contractual arrangements between the principal debtor and the bank which make the principal contract's terms materially different in a potentially disadvantageous respect from the terms the surety would naturally expect. In *Levett v Barclays Bank [1995] 1 WLR 1260*, it was a condition of the loan agreement that the loan would be repaid from the proceeds of the security provided by the guarantor, of which the guarantor was unaware. The bank failed to disclose this unusual term and was held liable to the guarantor in damages following the sale of the security. However, this principle is rarely successfully invoked.

Common law duty of care when advising

In response to claims for negligent advice, banks sometimes deny liability by referring to the absence of any duty to advise. However, this overlooks the important distinction between:

- A duty to advise, which is a duty generally not owed by banks.

- A duty to take care when advising, which (following *Hedley Byrne*) is recognised as a normal incident of the banker-customer relationship.

Despite the principle laid down in *Hedley Byrne*, banks have rarely been found liable for negligent advice, even after the plethora of mis-selling cases following the 2008 financial crisis.

What is advice?

One challenge for claimants is satisfying the court that the bank gave advice. The word "advice" is well understood to express a value judgment calculated to guide or influence the advisee's decision on a course of action (see, for example, *Rubenstein v HSBC Bank Plc [2011] EWHC 2304 QB at paragraph 81*: see Personal recommendation and advice under the regulatory system). That seems uncontroversial, but case law shows that disputes often arise as to whether statements made by a bank manager or other employee amounted to advice or were merely facts, personal opinion or sales talk.

Characterising every statement that may influence the customer's decision as advice could expose banks to liabilities on many fronts, and stifle the free exchange of views between relationship managers and their customers. These concerns may underlie decisions such as *Morgan v Lloyds Bank plc [1998] Lloyd's Rep Bank 73*, where the claim was founded on a letter from the bank manager stating that the customer should sell their nursing home business quickly as a going concern or the bank would make formal demand and sell as mortgagees. The Court of Appeal held that the bank's actions were "in its capacity as mortgagee to give a choice, not give its advice in its capacity as banker to its customer". Similarly, in *Murphy v HSBC plc [2004] EWHC 467 (Ch)*, Silber J declined to construe the bank manager's comments on what the bank thought of the proposition of lending to the claimants as advice.

However, in some cases, the courts have held that the bank went clearly beyond the usual role of a bank manager offering encouragement. In *Verity v Lloyds Bank [1995] CLC 1557*, the plaintiffs, as customers of Lloyds, had seen its pamphlet "Starting a Business", which stated, among other things: "We don't help only with money. Our advice is tailor-made, confidential and free." They approached their bank manager for advice and to raise the necessary finance. The manager went with them to inspect two properties. He expressed reservations about the first but said that the second was financially viable and encouraged them to proceed. The project went badly wrong for reasons that the bank manager should have foreseen and the bank was held liable in negligence.

Difference between deliberate advice and casual conversations

To prevent liability from arising too easily for banks, the courts carefully consider the circumstances in which the alleged advice was given. In *Hedley Byrne*, the House of Lords distinguished between "deliberate advice", to which liability would attach, and "casual or perfunctory conversations", in which banks may say things without assuming legal responsibility for them.

In *Wilson v MF Global [2011] EWHC 138 (QB)*, the court held that the conversations in which the advice was allegedly given were best characterised as "exchanging information and 'bouncing ideas' off each other or swapping hunches about the market", much of it being "spontaneous and off the cuff". The court declined to hold that the defendant had assumed any responsibility for what was said.

In *Libyan Investment Authority v Goldman Sachs International [2016] EWHC 2530 (Ch)*, a claim concerning the sale of complex investment products, Rose J drew what she described as a "critical" distinction between:

- "A situation where the bank gives advice on stock market opportunities going beyond the normal remit of a counterparty bank."
- "Situations where senior executives of the bank and the client have general discussions in an informal setting about how the individuals see the markets developing and about the prospects for particular stocks or sectors."

(*Paragraph 258*.)

While liability may be attached to the former, no liability is attached to the latter.

These and similar cases suggest that banks should be able to offer informal support or encouragement, or lay out potentially unattractive choices to a customer in difficulties, without incurring liability. This may be because what is said does not count as advice, or because the customer could not have understood that the bank was assuming responsibility for it.

More emphasis on the purpose and use of advice

In June 2021, in *Manchester Building Society v Grant Thornton UK LLP [2021] UKSC 20*, the Supreme Court seemed to indicate that more emphasis should be given to the purpose and commercial rationale of the advice, "the purpose of the duty of care to be served by the defendant". This decision seems to mitigate the difficulties that have arisen in practice when attempting to distinguish between advice and information.

In this case, as a result of the negligent advice of an auditor (the defendant), the building society (the claimant) had been exposed to the regulatory capital risks it wanted to avoid by seeking advice from the auditor. The losses that resulted from using an inadequate accounting treatment following the auditor's advice were regarded by the court as being part of the scope of the duty owed by the auditor.

This decision highlights the importance of banks and other financial institutions agreeing to the purpose and use of their advice and work to clients, prior to the start of a transaction. It also emphasises the need for Sales and Trading to document such information properly in the notes attached to their client accounts.

Distinction between an advisor and a salesperson

Arguably more problematic are cases in which the courts have drawn a distinction between an advisor and a salesperson. The result may be that a salesperson may extol the virtues of a product and use arguments to persuade the customer to enter into it, without giving advice to the customer to which liability will attach, as in *London Executive Aviation Ltd v RBS [2018] EWHC 74 (Ch)*. Historically, mere sales talk or "puffery" attracts no liability. However, on standard *Hedley Byrne* principles, statements intended to be taken seriously and relied on should attract liability; outcomes should not depend on the job description of the person making the statement. The "ultimate question" is whether, viewed objectively, the facts of the transaction show that the bank assumed a responsibility to advise on its suitability (*Fine Care Homes Ltd v National Westminster Bank Plc [2020] EWHC 3233 (Ch) at paragraph 107*).

A defendant may, however, be liable for presenting information selectively. In *Crestsign v National Westminster Bank [2014] EWHC 3043 (Ch)*, the court accepted that by presenting only a selection of the available products, and by "steering" the claimant in the direction of the particular product chosen, the bank's salesperson had "in substance" given advice and recommended the product. Since the product was unsuitable, the bank would have been liable in negligence, but for the bank's standard documentation that disclaimed responsibility for giving advice (see Disclaimers and "non-reliance" clauses). For more information, see Practice note, Claims for financial misselling under English law.

Personal recommendation and advice under the regulatory system

For the FCA rules to apply, generally the bank must conduct the regulated activities of advising on particular regulated financial products. The FCA has issued perimeter guidance, set out in the Perimeter Guidance manual (PERG), that addresses a variety of scenarios and issues that commonly arise when banks provide advice. Specific guidance has been issued on what constitutes the regulated activities of advising on:

- Investments (PERG 8.24).
- Contracts of insurance (PERG 5.8).
- Regulated mortgage contracts (PERG 4.6).

The rules on advice tend to apply if the bank makes a personal recommendation. The definition of a personal recommendation involves a recommendation to take a particular step (such as to buy a regulated investment) according to the glossary to the FCA Handbook. This recommendation must be either:

- Presented as suitable to the investor.
- Based on the specific circumstances of that investor.

The recommendation must not be issued exclusively to the public.

This definition of a personal recommendation has expressly applied since 1 November 2007. Further, in *Wilson v MF Global*, Eady J concluded that definitions used before 1 November 2007 (which were more loosely defined) had the same effect as the current definition and no distinction arises between the various definitions used.

The FCA has issued further guidance on the meaning of personal recommendation for regulated investments in Annex 1 of PERG 8. At a high level, a personal recommendation requires some comment or value judgment on a specific course of action. This can be explicit or implicit.

For example, a personal recommendation may be given where information is presented in a way that is selected to influence the decision, or expressly limits the options. The court will place significant weight on the FCA's guidance. For example, in *Rubenstein v HSBC*, the meaning of advice was considered by HHJ Havelock-Allan QC, in the light of the guidance in PERG from the then FSA. He concluded that key to the giving of advice is that the information is either:

- Accompanied by a comment or value judgment on the relevance of that information to the client's investment decision.
- Is itself the product of a process of selection involving a value judgment so that the information will tend to influence the decision of the recipient.

He stated that, in both these scenarios, the information acquires the character of a recommendation (*paragraph 81*).

This approach to defining what constitutes advice was adopted and applied by the Court of Appeal in *Adams v Options UK Personal Pensions LLP [2021] EWCA Civ 474*. It was held in this case that steering an investor to a particular pension provider and its products, with the aim of investing through it in certain other recommended investments, could amount to advice on that pension product (*paragraphs 72-82*).

However, in *Wilson*, Eady J emphasised the need to analyse whether a particular statement amounts to a personal recommendation in context. In this case, the terms of the agreements under review provided for an execution-only account. Over many years the customer had discussed with his broker a proposed strategy and obtained his observations. That strategy formed the backdrop against which their discussions took place, but it was not something the broker was called on to advise on, nor did he ever do so. While the broker may have reacted and made suggestions, Eady J cautioned these could not be construed as "personal recommendations" because of the very context in which they were made (*paragraphs 102-103*).

Similarly, in *Bank Leumi (UK) plc v Wachner [2011] EWHC 656 (Comm)*, Flaux J made the following observations when concluding that there was insufficient evidence to show that advice had or should have been given:

- The relationship was an "execution-only" account.
- The contract between the parties stated that in the absence of a specific agreement, no advice would be given and that the customer was relying on their own judgment.
- The general nature of the relationship did not indicate that advice was being or should be given.
- Statements made were more in the nature of "trading-floor opinion" than advice on the merits or suitability of any specific investment and fell a long way short of any sort of personal recommendation.

(*Paragraphs 306-307*.)

For more information, see Practice note, Claims for financial misselling under English law.

Disclaimers and "non-reliance" clauses

Disclaimers are common in bank documentation. They have had a significant impact on the course of mis-selling litigation, since the decisions of the Court of Appeal in *Peekay v Australia and New Zealand Banking Group [2006] 2 Lloyd's Rep 511* and *Springwell Navigation Corp v JP Morgan Chase Bank [2010] 2 CLC 705*. These cases concerned a "non-reliance" clause, common in derivative sales (including those executed under the ISDA Master Agreement), which declares that neither party is acting as the other party's adviser or relying on the other for investment advice. A new principle emerged from these cases called "contractual estoppel", whereby a person who has entered into a contract containing such a disclaimer is estopped from alleging that they received negligent advice from the other party or relied on this advice when buying a particular product.

In *Marz Ltd v Bank of Scotland plc [2017] EWHC 3618 (Ch)*, the terms of business for retail customers set out an express duty on the bank to take reasonable steps to determine if a "recommendation or suggestion" was suitable. However, the ISDA Master Agreement included a clause whereby the Master agreement superseded other documents, in relation to specific transactions. The court held that the ISDA Master Agreement should prevail in relation to the swap.

The special potency of these clauses was said to be that they were not amenable to challenge under the Unfair Contract Terms Act 1977 (UCTA) because, rather than excluding liability, they were "duty defining" or "basis" clauses, which prevented any duty from arising in the first place.

Crestsign was a powerful illustration of the impact of non-reliance clauses. The judge held that the bank gave advice and that the advice was negligent. However, the bank had sold the product on terms that included a non-reliance clause. The judge held that if UCTA had been applicable to the clause, he would have found it unreasonable having regard to:

- The complexity of the product.
- The imbalance of expertise between the parties.
- The non-availability of advice on the product from other sources.

Applying *Peekay* and *Springwell*, however, he considered that UCTA did not apply, so he had no choice but to give effect to the clause and dismiss the claim.

Since *Crestsign*, the Court of Appeal has held that non-reliance clauses are not in fact immune from the application of the UCTA reasonableness test (*First Tower Trustees Ltd v CDS (Superstores International) Ltd [2018] EWCA Civ 1396*). This decision came too late for most mis-selling claimants complaining of products sold before the 2008 financial crisis.

Regulatory position on disclaimers

When banks do in fact advise on regulated investments, insurance or mortgages within the regulatory regime, rules in the FCA's Conduct of Business sourcebook (COBS), Insurance: Conduct of Business sourcebook (ICOBS) and Mortgages and Home Finance: Conduct of Business sourcebook (MCOB) prohibit outright the exclusion or restriction of any duty or liability that banks owe under the regulatory system or any other duty or liability (COBS 2.1.1R, *COBS 2.1.2R,* ICOBS 2.5.1R(1), MCOB 2.6.2R *and MCOB 2.6.3R* (the No-Exclusion Rules)).

The glossary to the FCA Handbook defines the regulatory system as including:

- The rules in COBS, ICOBS and MCOB.
- Any provisions of and made under the Financial Services and Markets Act 2000 (FSMA), which includes various rights to enforce breaches of those rules.

Any term of an agreement or other communication with such effect would be in breach of these rules and would give rise to a right of action for damages. This could also give rise to an argument that any relevant term of an agreement is void for illegality.

Basis clauses (for example, provisions that the bank is not providing advice, that an execution-only service is provided or that the customer is not relying on any advice) involve a risk of breaching the No-Exclusion Rules where the bank does, in fact, provide advice or the customer does rely on any advice. The rules are to be interpreted purposively (see GEN 2.2.1R).

In *Parmar v Barclays Bank plc [2018] EWHC 1027 (Ch)*, the court held that COBS 2.1.2R goes further than the protections created in unfair terms regulation and prevents a party "creating an artificial basis for the relationship, if the reality is different." The court stated that, if a bank employee is in fact giving advice, then having a disclaimer or statement which in effect states that he or she is not to be regarded as an adviser, with the effect that COBS 9 does not apply, is void because it is a "communication relating to designated investment business seeking to ... exclude or restrict any duty ... it may have to a client under the regulatory system." (*paragraph 133*). For more information, see Relationship of regulatory rules with common law duty of care.

Further, in *Adams v Options*, the Court of Appeal decided not to enforce an execution only contract pursuant to sections 27 and 28 of FSMA and ruled that Options UK Personal Pensions LLP (the defendant) must compensate Mr Adams (the claimant) for the loss he had suffered as a result of the negligent advice provided by an unauthorised introducer selected by the defendant. At the core of this decision is section 28 of FSMA, which gives discretion to the court to pursue the main objective of FSMA to protect consumers.

This decision has wider consequences for financial services firms that deal with unauthorised and unregulated third parties for assistance. Financial institutions may need to check if the assistance given by third parties they have engaged is a regulated activity and, if necessary, check authorisations have been obtained. Otherwise, they could be exposed to the risks associated with the models of the third parties.

Duties in relation to the provision of information

The *Hedley Byrne* principle applies as much to providing information as it does to providing advice. This means that banks may attract liability for what they say about a proposed transaction even if what they say falls short of advice or a recommendation.

Liability in respect of inaccurate statements may arise in deceit, under the Misrepresentation Act 1967 or in negligence at common law. Those forms of liability are standard and are not addressed in this note. For more information, see Practice note, Misrepresentation. These are not the only forms of liability that can attach to the provision of inadequate information falling short of advice.

Common law duty of care when explaining the transaction

An example of a duty of care arising when explaining the transaction is illustrated in *Cornish v Midland Bank plc [1985] 3 All ER 513*. The bank manager had explained the effect of a mortgage transaction to the plaintiff. The bank was held liable because the manager negligently failed to explain to her that the security would extend to unlimited future borrowing by her husband. The manager was not advising the plaintiff whether to enter into the transaction, but simply informing her what it meant and what its implications were. Nothing that he said was wrong or a misrepresentation of the kind that would have justified rescission of the contract. However, the court held that having assumed responsibility for explaining the transaction, the bank owed a duty to ensure that the explanation was adequate.

Providing the upside and the downside of a proposal

This principle may apply to more "sophisticated" customers as well, as in *Bankers Trust International plc v PT Dharmala Sakti Sejahtera [1996] CLC 518*, in which it was held (as later summarised by the Court of Appeal in *Property Alliance Group v RBS [2018] WLR 3529*) that "the bank put forward an explanation that entering into the proposed substitute swap would improve the risk exposure of the customer", and therefore owed a duty to present "the downside and upside of the proposal in a balanced fashion", using a "properly constructed graph and letter". Again, nothing the bank had said was wrong but it was inadequate for its known purpose.

Mezzanine duty

Relying on Cornish and Bankers Trust, the court in Crestsign accepted that "a bank which undertakes to explain the nature and effect of a transaction owes a duty to take reasonable care to do so as fully and properly as the circumstances demand". In *Crestsign*, this duty was labelled the "mezzanine duty". The claimant's counsel (the late author of this note, Richard Edwards QC) invented this term to convey that it lay somewhere in between the high-level duty owed by an advisor and the low-level duty to avoid making negligent misrepresentations. The Court of Appeal in Property Alliance Group disapproved of the label but approved of the concept, emphasising that in each case it would be necessary to undertake a close analysis of "the responsibility assumed in the particular factual context as regards the particular transaction or relationship in issue".

The future of the *Cornish*, *Bankers Trust* or *Crestsign* duty remains to be worked out in the light of the judgment of the Court of Appeal in *Property Alliance Group*. Such a duty was rejected in *CJ & LK Perk Partnership v Natwest Markets plc [2022] EWHC 726 (Comm)*, in part because it had not been pleaded (*paragraphs 179 to 230*). But, based on first principles, it seems that the key is to identify the nature of the task which the bank has set out to perform. The courts must place a limit on the principle or it may in effect introduce a duty to warn by the back door. However, where the customer is clearly relying on the bank to explain the transaction (especially if the transaction is unfamiliar), and where the bank undertakes to provide the explanation, there may be a reasonable expectation that the explanation should go further than a mere factual description and refer to material risks.

Regulatory position on non-advised sales

Under the regulatory system, banks will also owe a myriad of obligations on sales, even if not advised, in relation to any of the following:

- Information disclosure.
- To assess appropriateness.
- To prevent the customer from failing to take advice, in relation to sales.

These obligations are addressed in the following practice notes:

- Conduct of business regulation: COBS overview.
- Insurance conduct of business regulation: ICOBS overview.
- Mortgage conduct of business regulation: MCOB overview.

Assessments of suitability under the regulatory system

The rules in the COBS sourcebook have applied since 1 November 2007 and concern, among other things, the activities of advising on or arranging regulated investments.

The key rule governing the provision of advice on regulated investments is the so called "suitability" rule. This rule depends on the making of a personal recommendation (see Personal recommendation and advice under the regulatory system).

COBS rules

The COBS rules currently reflect slightly different wording for:

- Investments falling within the scope of the MiFID II Directive (2014/65/EU), as implemented in UK law and regulation.
- Those regulated investments falling outside that scope, for example life insurance policies.

For more information on the scope of MiFID II, see Practice note, MiFID II: overview: What investment services and activities does MiFID II apply to?.

For investments within the scope of MiFID II, the suitability rule is set out in COBS 9A.2.1R, which states that, when providing investment advice or portfolio management, a firm must obtain the necessary information regarding the client's:

- Knowledge and experience in the investment field relevant to the specific type of financial instrument or service.
- Financial situation including his or her ability to bear losses.
- Investment objectives including his or her risk tolerance.

A firm must do this so as to comply with COBS 9A.2.1R(2), namely recommend investment services and financial instruments, or take the decision to trade, which is suitable for the client and, in particular, in accordance with the client's risk tolerance and ability to bear losses.

This rule applies in relation to any business within the scope of MiFID II and encompasses business with retail and professional clients but not eligible counterparties. For further information, see Practice note, FCA suitability requirements for MiFID business and IBIPs (COBS 9A).

This rule places a greater emphasis than in previous MiFID and pre-MiFID rules on the ability to bear loss and risk tolerance, but is otherwise materially identical to those previous rules.

For investments outside the scope of MiFID II, the suitability rule is in substance similar to that in MiFID II and is set out in COBS 9.2.1R. A firm must:

- Take reasonable steps to ensure that a personal recommendation, or a decision to trade, is suitable for its client.
- Ensure that any life policy proposed is consistent with the client's insurance demands and needs.

(*COBS 9.2.1R(1)*.)

Further, when making the personal recommendation or managing the client's investments, the firm must obtain the necessary information regarding the client's:

- Knowledge and experience in the investment field relevant to the specific type of designated investment or service.
- Financial situation.
- Investment objectives.

This must be obtained so as to enable the firm to do one of the following:

- Make the recommendation or take the decision that is suitable for the client.
- In the case of a life policy, propose a contract that is consistent with the client's insurance demands and needs.

(*COBS 9.2.1R(2).)*

This rule applies in relation to a personal recommendation made to a retail client (COBS 9.1.1R) (that is, a client who is not a professional client or eligible counterparty (COBS 3.4.1R)).

For more information, see Practice note, FCA suitability requirements for non-MiFID business and non-IBIPs (COBS 9).

Case law related to the COBS suitability rule

While case law considering the suitability rule is likely to be of general application, there is an increased emphasis within the MiFID II scope on the client's ability to bear loss and risk tolerance. Most of these cases will turn on their particular facts and on expert analysis of whether particular advice was suitable. These cases are instructive as to how the court has approached assessments of suitability in particular situations:

- In *Zaki v Credit Suisse (UK) Ltd [2013] EWCA Civ 14*, a case decided under COB, Rix LJ held that a determination of suitability may be correct, even if the bank did not correctly carry out the process leading to that determination, for example by failing to assess the customer's financial standing properly (*paragraphs 7 and 70-84*). The determinations of suitability at first instance by Teare J were upheld (*Zaki v Credit Suisse (UK) Ltd [2011] EWHC 2422 (Comm)*). The bank had recommended investments in various leveraged structured products that suffered losses during the 2008 financial crisis. The customer, who it was agreed was a private customer under COB, was seeking enhanced returns and the risk involved in the products was therefore appropriate. The recommendations covered ten separate investments made over time. The first seven investments were suitable despite the leverage and lack of diversification. However, after this point, markets had become volatile. This meant that the lack of diversification and leverage made the recommendations for a further three investments unsuitable.
- In *Wilson v MF Global*, a case decided under COB, Eady J considered that (if he was wrong in other matters on which he had decided the case) an investment strategy of day-to-day trading in derivatives was suitable for the customer where:
  - it was the customer's favoured and desired strategy;
  - it was consistent with the customer's objectives, recorded to be to make a profit within a short term (a one-year time horizon); and
  - there was evidence that a longer-term strategy would have produced a better result, but that evidence depended on hindsight and was irrelevant in establishing whether it was the wrong strategy at the time.

  (*Paragraphs 113-116*.)
- *Rubenstein v HSBC Bank plc [2012] EWCA Civ 1184* is a case decided under COB. This case was based on COB 5.3.5R(2), which required the recommendation of the "most suitable" product where that product was a packaged product. Rix LJ however noted that this can be regarded as a sub-species of the general rule to recommend a suitable product, breach of which leads to a breach of the suitability rule (*paragraph 55*). It was held that the bank had recommended an unsuitable fund that was presented as meeting a standard of being the same as cash (but in fact involved market risk). The recommendation also failed to consider the suitability of other funds. For example, in this case another fund was more suitable in terms of risk.
- In *Worthing v Lloyds Bank plc [2015] EWHC 2836 (QB)*, a case under COBS, it was held that an annual review into an existing investment had been carried out with reasonable skill and care. This was because:
  - the customer's investment objectives had not changed;
  - it was reasonable to advise not to take any immediate decision to sell; and
  - the investment remained suitable for the customer.

This case illustrates the application of the suitability test to ongoing advice during portfolio management review.

- In *O'Hare v Coutts and Co [2016] EWHC 2224 (QB)*, a case under COBS, the claimant claimed the bank had recommended an unsuitable investment without capital protection. Kerr J held that the investments were in fact suitable. This was because:
  - the customers were not entirely unsophisticated;
  - the customers were willing to take risk (and an adviser is not in breach if they persuade a customer to take more risk than they otherwise would, since such advice can condition the risk appetite of the customer);
  - the investments were diversified; and
  - the losses that arose as a result of the 2008 financial crisis were not foreseeable at the time.

  (*Paragraphs 215 to 223*.)
- In *Abdullah v Credit Suisse (UK) Ltd [2017] EWHC 3016 (Comm)*, a case under COBS, Andrew Baker J held that certain recommendations to invest in structured capital-at-risk notes were unsuitable for the customers. This was because the customers were only willing to accept minimal risk to their capital. However, one of the notes that was recommended was in fact high risk. There was also no reasonable basis for believing that the note was low risk. Accordingly, the recommendation was for an unsuitable product. Other notes were recommended that were also high risk, however this was clearly identified to the customers as high risk. This was accepted by the customers as a departure from their general low risk approach to investments. This was either because of the modest amount that was being invested in that note or because it was an amendment to the investment of sums already held in high-risk notes. It was held there was no breach of the suitability rule in regard to the higher risk notes that were clearly identified and accepted as such.

Regulated insurance (ICOBS): rules and cases

ICOBS rules

The present suitability rule in ICOBS is set out in ICOBS 5.3.1R, which has stated (since 6 January 2008):

> "A firm must take reasonable care to ensure the suitability of its advice for any customer who is entitled to rely upon its judgment."

"Customer" is broadly defined to include any actual or prospective policyholder. It excludes a policyholder or prospective policyholder who does not make the arrangements preparatory to the conclusion of the contract of insurance. The policyholder is defined broadly, extending beyond the mere legal holder of the policy, as:

> "the person who for the time being is the legal holder of the policy, including any person to whom, under the policy, a sum is due, a periodic payment is payable or any other benefit is to be provided or to whom such a sum, payment or benefit is contingently due, payable or to be provided ..."

This rule is materially identical to the previous suitability rule set out in ICOB 4.3.1R(1) (applicable from 14 January 2005). These rules reflect the UK implementation of the Insurance Distribution Directive ((EU) 2016/97) (IDD)) and its predecessor, the Insurance Mediation Directive (2002/92/EC) (IMD)).

Case law related to the ICOBS suitability rule

In addition to the detailed rules and guidance issued by the FCA in ICOBS (and the predecessor regime in ICOB), the following cases have considered the relevant obligations in detail:

- In *Harrison v Black Horse Ltd [2010] EWHC 3152 (QB)*, HHJ Waksman QC held that the reference in a previous express requirement in ICOB 4.3.6R (which is likely subsumed into the present suitability rule in ICOBS) to take into account cost "where ... relevant" meant that this is not always relevant and would become relevant if a customer identifies a particular budget and the intermediary was not bound to ask if a budget existed (*paragraph 23*).
- In *Jones v Environcom Ltd [2010] EWHC 759 (Comm)*, a case under ICOB, David Steel J considered the obligation to ensure suitability required consideration of whether the policy of insurance is voidable for non-disclosure (*paragraph 63*). A void policy is plainly not a suitable one. In this case, the broker sought to argue that it had given notice of the obligation to give disclosure, but it was held that it was not sufficient to rely on standard terms such as these. The broker had to satisfy themselves the customer in fact understands the obligation. This requires specific engagement on the issue between the broker and the customer.
- In *Saville v Central Capital Ltd [2014] EWCA Civ 337*, Floyd LJ held, in a case under ICOB concerning the suitability of a sale of PPI, that the broker should have ascertained the customers' demands and needs as to the length of insurance they required rather than assuming this from an acceptance of what they were offered. The court did not determine or remit the issue of whether as a result of this failure the policy was in fact unsuitable, as the appeal succeeded on other grounds.

- *Scotland v British Credit Trust Ltd [2014] EWCA Civ 790* records the first instance decision at paragraph 12 (to which there was no challenge on appeal). It was held that brokers, acting for the lender, had sold an unsuitable policy of PPI in breach of the rules under ICOB. In particular, the PPI was unsuitable in circumstances where the term of the policy was shorter than the term of the loan it was intended to cover and where the broker had failed to identify that the customer already had an entitlement to sick pay that would cover lost income in the event of sickness. This formed part of a finding that an unfair relationship between the customer and the bank had arisen under section 140A of the Consumer Credit Act 1974.
- In *Goodman v Central Capital Ltd [2012] EWHC 8 (QB)*, HHJ Brown QC rejected a claim in relation to the unsuitability of PPI. The claim focused on a mismatch between the length of cover and the loan it was to protect and on an alleged need to cover both claimants' income. The basis for the claim was that the term had been raised with the customers and not prompted concern and only one of the claimants' income was being relied on to repay the loan. This case particularly turned on the determination that the claimants were not credible witnesses.

Regulated mortgages (MCOB): rules and cases

MCOB rules

The suitability rule in MCOB applies to a bank when it advises a customer to enter into or vary a regulated mortgage contract. The suitability rule is set out in MCOB 4.7A.2R:

> "If a firm gives advice to a particular customer to enter into a regulated mortgage contract, or to vary an existing regulated mortgage contract, it must take reasonable steps to ensure that the regulated mortgage contract is, or after the variation will be, suitable for that customer."

This rule has been in place since 26 April 2014, following the introduction of the Mortgage Credit Directive (2014/17/EU) (MCD) and is in materially the same terms as the rule that preceded it, MCOB 4.7.2R (in effect since 31 October 2004). Additional rules (in MCOB 4.7A.5R and MCOB 11.6.2.R post-MCD and formerly MCOB 4.7.4R) provide that a mortgage is suitable if, by reference to facts, the bank is, or should be, aware that there are reasonable grounds to conclude the mortgage is:

- Affordable.
- Appropriate to the need and circumstances of the customer.
- The most suitable product within the scope of advice service provided by the bank to the customer.

These obligations fall on an advising bank. However, post-MCD, the obligation to assess affordability falls on the lender (if different from the adviser). This means that, in the unlikely scenario that a bank advised on a mortgage provided by another lender, the obligation to assess affordability will fall on that other lender. MCOB 4.7, MCOB 4.7A and MCOB 11 (as applicable) contain further detailed rules and guidance explaining the application of the suitability rule and assessment of affordability in particular circumstances.

Case law related to the MCOB suitability rule

In addition to the detailed rules and guidance issued by the FCA in MCOB, the following cases have considered the relevant MCOB obligations in detail:

- In *Mason v Godiva Mortgages Ltd [2018] EWHC 3227 (QB)* (a post-MCD case), the bank had not acted as adviser on a mortgage, but (as identified above), still owed an obligation to assess affordability under obligations in MCOB 11. The claimants had mortgaged their home to fund the acquisition and development of some land. They claimed that the bank should have known that their self-certified application had been incorrectly filled in by their independent financial adviser with an overstated level of income. The court held there was no breach of the requirement to assess affordability where it appeared the loan would be repaid out of the sale of property and it was plausible that the customers as property developers might have been earning the stated income. This means that banks are able to rely on information that seems plausible when assessing the affordability of a mortgage for an applicant.
- *Emptage v Financial Services Compensation Scheme Ltd [2013] EWCA Civ 729* is a pre-MCD case, which in fact only records the conceded position of the FSCS. The court had accepted that there had been a breach of the suitability rule where the customer had been recommended an interest-only mortgage where the repayment of the principal depended on the profitability of uncertain investments in Spanish property (which had been funded by the mortgage). The customer would have had no prospect of repaying the mortgage without those investments succeeding.

Other regulated financial products

Banks may also owe duties under the regulatory regime in relation to other financial products and services provided, for example in relation to:

- The sale and operation of bank accounts and payments services (under the Banking: Conduct of Business sourcebook (BCOBS). and the Payment Services Regulations 2017 (SI 2017/752)). For more information, see Practice note, FCA Banking and Payments Conduct Regime: overview.

- The sale of consumer credit products (under the Consumer Credit sourcebook (CONC). and the Consumer Credit Act 1974). For more information, see Practice note, UK consumer credit regime: overview and Practice note, FCA consumer credit regulation: overview of Consumer Credit sourcebook (CONC).

Relationship of regulatory rules with common law duty of care

As stated by Rose J in *London Executive Aviation Ltd v Royal Bank of Scotland plc [2018] EWHC 74 (Ch)*, the courts are alive to the need to keep the distinction between claims for breach of regulatory requirements and actions in negligence at common law (*paragraph 166*). This is because they give rise to distinct causes of action. The relationship between the two causes of action is complex.

As to an action at common law, in *Green v Royal Bank of Scotland plc [2013] EWCA Civ 1197*, it was argued that the application of a regulatory rule in circumstances where breach of that rule could cause loss to a customer would suffice to create a co-extensive duty of care with the regulatory rules. It was also argued that a rule that requires the bank to advise (even on an execution-only transaction) on the nature of risks inherent in a transaction should result in a co-extensive duty of care.

This was rejected by the Court of Appeal, which stated it was not an actionable breach of a statutory duty of care or common law duty of care, because of the statutory remedy provided within FSMA that is now found in section 138D of FSMA. To recognise such wider rights of action would be to drive a "coach and horses" through the regime provided for by parliament. A claim based on the statutory remedy in FSMA was not available as it had been abandoned in the belief it was time-barred. For more information on the right of action in section 138D, see Practice note, Actions for damages under FSMA.

However, the standard of reasonable care due (where such a duty arises at common law) can be informed by regulatory obligations. This was acknowledged in *Green v Royal Bank of Scotland* (referencing previous decisions) in the following terms:

> "By contrast, the judge was prepared to recognise that, had the bank undertaken an advisory duty, the content of that duty would have been in part informed by the content of COB 2.1.3R and COB 5.4.3R. That approach has been endorsed on at least four occasions by first instance judges. The first of them Judge Raymond Jack QC, in *Loosemore v Financial Concepts [2001] Lloyd's Rep PN 235, 241*, pointed out that the skill and care to be expected of a financial adviser would ordinarily include compliance with the rules of the relevant regulator: see also per Judge Havelock-Allan QC in *Seymour v Ockwell & Co [2005] PNLR 758* and by the same judge in *Rubenstein v HSBC Bank plc [2012] PNLR 151*. In *Shore v Sedgwick Financial Services Ltd [2008] PNLR 244, para 161*, Beatson J put it this way:
>
> 'It is common ground that [the financial advisers] owed [the claimant] a common law duty to act with the skill and care to be expected of a reasonably competent financial adviser. In determining the extent of this duty, it is useful to start with the requirements of the relevant regulatory regime, in this case the SIB [Securities and Investments Board] principles and the IMRO [Investment Management Regulatory Organisation] rules. This is because the skill and care to be expected of a reasonably competent financial adviser ordinarily includes compliance with the relevant regulatory rules.'"

Similarly, in *Thomas v Triodos Bank NV [2017] EWHC 314 (QB)*, the bank, in advertising its subscription to the Business Banking Code, owed a duty that encompassed a promise that, if the bank was asked about a product, it would give the customer a balanced view of the product in plain English, with an explanation of its financial implications (*paragraph 81*).

Regulatory duties can also be incorporated into a contract and an action brought for breach of contract. Such terms can be expressly incorporated, as they were in *Larussa-Chigi v CS First Boston Ltd [1998] CLC 277*. In this case it was held in the contract that certain foreign exchange transactions were expressly subject to the London Code of Conduct issued by the Bank of England.

Issues for dispute are more likely to arise if an argument is made that such duties have been incorporated by an implied term. This will be subject to the general law on the implication of contractual terms. Arguments surrounding implied terms were considered in the following cases:

- *Larussa-Chigi v CS First Boston Ltd* (see above), in which Thomas J expressed the view that if he was wrong about express incorporation, it was obvious the parties would have intended the transactions to be subject to the London Code of Conduct rather than leave them unregulated and was therefore prepared to imply a term to that effect.
- *Clarion v National Provident Institution [2000] 1 WLR 1888*, where Rimer J rejected an argument that Securities and Investment Board Principles were incorporated into a fund switching agreement, on the basis that it was not obviously required.
- *Flex-E-Vouchers Ltd v Royal Bank of Scotland [2016] EWHC 2604 (QB)*, in which Waksman J applied

Clarion and rejected an argument that the entire regulatory regime, including the FCA's Principles for Businesses and detailed rules in COBS, should be implied into a swap agreement. Again, they were not obviously required given the existence of the regulatory regime and the contract was commercially coherent without them.

For more information, see Practice note, Contracts: express and implied terms.

An express or implied contractual duty of skill and care may require a bank to comply with regulatory rules, as in *Green v Royal Bank of Scotland*. Such rules may also be relevant to whether an unfair relationship has arisen between a customer and a provider of consumer credit (see *Plevin v Paragon Personal Finance Ltd [2014] UKSC 61; Scotland v British Credit Trust Ltd [2014] EWCA Civ 790* and *Kerrigan v Elevate Credit [2020] EWHC 2169 (Comm)*).