Bank liability

Electronic forex trading with leverage

Par Nicolas Ollivier le 21 July 2022

In a ruling handed down on April 21, 2022 (4A_412/2021), the Swiss Federal Supreme Court has upheld a decision handed down by the Cantonal Court of the Canton of Vaud, which dismissed a customer's claim against a bank concerning highly leveraged forex transactions (1:100) that caused losses following the abandonment of the CHF/EUR floor rate on January 15, 2015.

The dispute focuses on the following four main points.

I. Qualification of the contractual relationship

The customer complains that the bank did not have him sign an e-Forex contract, which it explained to FINMA was a necessary condition for access to its Forex platforms. The e-Forex contract in fact concerned a platform other than the one used by the customer. However, he had not demonstrated that such a contract was indispensable for access to the latter.

The appellant complained that he had not benefited from the clarification in the e-Forex contract that the bank was acting as the customer's counterparty, and therefore as a supplier of liquidity rather than as a commission agent. The Federal Court noted that the customer had neither alleged nor established that the bank had been instructed to act in its own name, but on its own behalf. On this basis, our High Court confirms that the foreign exchange transactions represented contracts of sale.

II. The duty to inform

The Chambre patrimoniale considered that, given the relationship of simple deposit and sales contracts, the bank owed him only a limited duty of information, limited to good faith (art. 2 CC).

The Federal Court found that the bank had clearly and sufficiently warned the client – supported by an independent manager – about the operation of stop-loss orders and the risks inherent in leverage. It excludes the application of art. 11 SESTA, on which the customer based his argument of a more extensive duty to inform. It is argued that the SESTA only applied to foreign exchange derivatives and not to spot foreign exchange transactions. As the client did not claim that the forex transactions at issue concerned derivatives, the Federal Court did not rule on the matter. It reiterated its jurisprudence to the effect that the scope of the duty to inform enshrined in art. 11 LBVM depends on the client's experience and knowledge. It attributed to the

customer those of his independent manager – who had identified the risks associated with leveraged currency trading – and considered that he did not need to be informed of this risk.

III. Liquidation without consulting the customer

The general terms and conditions stipulated that, in certain market conditions, providing for a stop-loss order did not necessarily limit losses to the specified amounts. The client contested the bank's right to liquidate his positions without consulting him, referring to the margin call clause. The Federal Court recalls that the margin is intended to protect the bank's risk in the event of the customer's insolvency. This is a separate issue from the question of when the stop-loss order should be executed, or whether the bank should be liable for losses arising from late execution of the order.

The courts ruled that the bank could rely on a special situation provided for in its general terms and conditions, justifying the suspension of foreign exchange trading and the subsequent liquidation of the position at a rate below the stop-loss rate. After the SNB's announcement, there was virtually no liquidity left on the market. It was legitimate to interrupt the system for 54 minutes, then liquidate the stop-loss orders, which were "at best" orders.

IV. The theory of fraudulent manipulation by the bank

According to the customer, the bank manipulated the stop-loss orders. In the quarter of an hour preceding the SNB's announcement at 10.30 a.m. on January 15, 2015, the bank's internal system manually set the price at CHF 1.19547 for EUR 1, whereas it was hovering around CHF 1.20 on the markets. This manipulation triggered the stop-loss orders (including the customer's) set at CHF 1.196 for EUR 1. The bank then manually prevented the orders from being executed, hoping to resell the positions later at a profit.

The courts ruled out the hypothesis of manipulation on the grounds that it had not been proven, the customer referring in bulk to the testimony of his manager (dismissed on the grounds that he had an interest in the outcome of the dispute) and to three voluminous documents (difficult to read and insufficient to corroborate the theory of manipulation).

The Federal Court considered that it was not known whether FINMA had followed up on the client's letter of suspicion. Finally, the Federal judges emphasized that the client still had the option of taking legal action, which he did not take.

This decision is in line with previous case law (4C.152/2002) and current Swiss law, which does not protect retail customers from a default leverage of 1:100 (unlike European regulations for certain products). Over and above this aspect, which falls within the legislator's remit, the ruling is justified by the fact that forex is a simple and transparent financial instrument in terms of cost (if the spread is disclosed), with risks that are easily apprehended by the investor, who has all the information needed to evaluate them (leverage, margin and price), unlike OTC products structured by banks. In the case of OTC products structured by banks, the Swiss Federal Supreme Court considers the bank to be a commission agent acting as counterparty (art. 436 CO). It is bound by a duty of fidelity prohibiting it from making an illicit profit (4A_547/2012).

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