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Margin Call

Severe market downturn due to COVID-19 pandemic

Par Roxane Pedrazzini le 1 December 2023

The Zurich Handelsgericht validates a margin call with a short delay of just over 24 hours in ruling HG200220-O of October 27, 2022, published on November 1, 2023.

In this case, the CEO of a company based in Scotland, a qualified “professional” investor, and his ex-wife open a banking relationship with a bank in Zurich. They are both linked to the bank by a high-risk investment advisory relationship. As part of the banking relationship, the bank grants them a Lombard loan against a pledge of all their assets deposited in their account. Under the terms of the relevant contracts, the credit granted may not exceed the collateral value calculated on an ongoing basis by the bank. The bank is also entitled to realize the collateral if the borrowers fail to meet any additional collateral requirements within the stipulated period.

Due to the fall in stock market prices in March 2020 as a result of the COVID-19 pandemic, the pledged shares no longer cover the Lombard loans. The bank therefore makes a margin call on March 17, 2020 at 9:24 a.m. and requires additional cover of CHF 370,000 by 12:00 p.m. on March 18, 2020. The CEO states that he and his ex-wife will not be able to provide the additional cover within the deadline, but that they will be able to do so if they have additional time. During the day on March 17, 2020, the CEO and the bank discuss various options for meeting the margin call.

In particular, the CEO requests the value of the pledged shares in order to identify which shares could be sold, as well as a brief extension of the deadline. The bank provides an estimate of the shares it recommends for sale. The CEO asks the bank to wait before selling certain shares, indicates that he will communicate his instructions the following day at 8:00 a.m., i.e. on March 18, 2020, and requests a brief extension of the deadline. The bank objects at 4:31pm on March 17, 2020, demanding immediate instructions and recommending that he sell all shares except those in the Scottish company of which he is CEO. The latter eventually declares “OK if it has to be that way” and the shares are sold shortly afterwards.

In November 2020, the CEO and his ex-wife filed a claim for payment against the bank.

The Handelsgericht found that the CEO had given express instructions to sell the disputed shares. After the sale of the shares, the CEO complained only about the shortness of the deadline, but did not contest having consented to the sale. This is therefore not a case of realization of the pledge and forced sale of the pledged assets.

Furthermore, according to the Handelsgericht, the bank did not breach its duty of care in this case when it recommended the sale of the disputed shares. In particular, according to the topical contracts, the bank has wide discretionary powers to determine the value of the pledged shares, and may reduce their value to zero at its discretion due to falling stock market prices. In addition, the bank can set a very short deadline for a margin call, and even liquidate the pledged assets before maturity if it appears certain, as in this case, that the customer will not be able to remedy the overdraft on his account within the stipulated timeframe. Lastly, the bank is not in a position of conflict of interest when it advises its customer on various solutions for reducing the overdraft. Consequently, the bank does not incur any contractual liability towards the plaintiffs, and their action for payment is dismissed.

The Handelsgericht's decision may seem harsh. The bank does not appear to be in a position to provide the CEO with full information, particularly on the value of the shares it recommends for sale. It pushed the CEO to give instructions before the deadline, and the proceeds of the sale amounted to more than a million, whereas the request for additional cover was CHF 370,000. However, given the collapse of the stock markets, the value of the shares probably continued to fall after the margin call. This confirms that the bank has considerable discretion in determining the value of the pledged assets.

That said, the Handelsgericht's findings in this case are based primarily on the fact that the CEO declared himself to be a "professional investor" in the bank. As such, he is obliged to (i) be aware of the risks associated with Lombard loans and leverage in the event of a sharp fall in the stock markets, in particular the high probability of a margin call at short notice and the liquidation of the pledged assets under unfavorable market conditions, and thus (ii) monitor stock market trends and (iii) not immediately agree to the sale of the pledged assets if he can seriously consider an alternative solution to meet the margin call within the given timeframe. This ruling thus suggests that a client qualified as a professional investor would indirectly agree to be subject to increased requirements in the supervision of his financial instruments and stock markets. These conclusions should, however, be qualified for less experienced clients.

This case also serves as a reminder that the client must avoid any behavior that could be interpreted as a confirmation or ratification, with the consequence of losing certain rights or prerogatives (in this case, the possible rights linked to the forced sale of shares and the possibility of waiting for the deadline initially set by the margin call). It also confirms the case law of the Handelsgericht, which authorizes a short period of a few days for the margin call (in this case a period of just over 24 hours) and the bank's discretionary power in this context.

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