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Bank liability insurance

Careful wording of insured risks

Par Romain Dupuis le 23 February 2024

In a recent ruling, the Swiss Federal Supreme Court upheld an insurance company's refusal to cover losses of more than 35 million dollars suffered by a Swiss bank forced to compensate unhappy investors at the end of legal proceedings in Dubai (ruling 4A_440/2022 of 16 November 2023).

A bank established in Switzerland has a subsidiary in Dubai, company E. The subsidiary is subject to supervision by the Dubai Financial Services Authority (DFSA) and is authorised to provide certain financial services, including investment advice. However, the subsidiary's business actually consists of marketing the financial products and services offered by the bank in the Middle East. The bank is not authorised by the DFSA.

Over an unspecified period of time, the bank invested $190 million in structured products on behalf of a wealthy family. Two employees of the Dubai subsidiary acted as intermediaries between the bank and the family.

As a result of the financial crisis in 2008, the investments in question (partly financed by loans) led to significant losses. After several unsuccessful margin calls, the bank liquidated the investments.

The bank and its subsidiary were then sued by the unhappy investors before the Dubai courts, which paid scant regard to the choice of court clause in favour of the Swiss courts and the clause providing for the application of Swiss law to the contracts binding the parties.

The bank then informed its insurance company, with which it had taken out professional liability insurance, of the proceedings. The insurance company provisionally confirmed cover and paid the bank CHF 5 million as an advance on its legal costs.

At the end of the proceedings, the Dubai court ruled that the bank had treated the two employees of its subsidiary who had acted as intermediaries as if they were its own employees, so that they had to be classified as "de facto employees" of the bank. On this basis, the court criticised the bank for providing financial services in Dubai without being authorised to do so by the DFSA.

Under Dubai law, contracts entered into in breach of the authorisation requirement cannot be relied upon by the offending party, so the investor can seek restitution of the amounts invested

as well as compensation for losses suffered.

As a result, the Dubai court ordered the bank and its subsidiary to pay more than 35 million dollars to the family.

On the strength of the provisional confirmation received at the start of the proceedings, the bank expected to be compensated by its insurance, but the latter ultimately refused cover. The bank then filed a claim for payment of CHF 10 million with the Zurich Handelsgericht. The insurance company counterclaimed for repayment of the CHF 5 million advance.

In a ruling dated 24 August 2022, the Handelsgericht rejected the bank's claim and upheld the insurance company's counterclaim, holding essentially that various conditions of cover had not been met.

The complaints raised by the bank in its appeal to the Federal Court are manifold. This commentary addresses only the one that led to the dismissal of the appeal, relating to the scope of cover.

This is described as follows in clause 3.1 of the policy :

"The insurance covers the civil liability of the insured bank and its employees for purely economic losses based on Swiss legal provisions on civil liability or on comparable and legally valid applicable national provisions, insofar as the injured party asserts a civil liability claim in writing against the insured bank or one of its employees during the term of the contract (…)".

After briefly recalling the principles applicable to the interpretation of a pre-formulated clause contained in an insurance policy, the Federal Court proceeded to interpret the aforementioned clause.

While it accepted, unlike the Handelsgericht, that the clause could in principle cover claims arising from banking services provided without the necessary authorisation, as well as cases of no-fault (causal) liability, the Federal Court was nevertheless strict about the scope of cover offered by the policy and considered that the contractual requirement of 'comparability' of legal provisions was of decisive importance in this case.

According to the Supreme Court, this additional condition was introduced by the insurer to enable it to assess the probability of a claim arising solely on the basis of Swiss law, without having to take account of other legal systems, in particular those that provide for punitive damages or similar institutions.

In this case, the Federal Court found that the bank was not accused of having breached its contractual obligations, but merely of having provided financial services without authorisation. It follows that the purpose of the payment ordered against the bank was not to compensate for a loss, but to deter those who violate the obligation to obtain authorisation, insofar as the customer is entitled to compensation solely on the basis of the lack of authorisation.

The Federal Court concludes that the basis of liability on which the bank was convicted under Dubai law is punitive in nature and is therefore not comparable to Swiss civil liability provisions, so that coverage is excluded.

This ruling, which was relatively harsh for the bank, highlights the vital importance of adequate insurance cover, particularly for institutions providing financial services in countries around the world whose legal systems differ significantly from Swiss law and which, by definition, have different liability bases. As the bank learned to its cost, a choice clause in favour of Swiss law and courts does not necessarily constitute sufficient protection.

Moreover, this objective is naturally in tension with the reluctance of Swiss insurers to offer cover for liability regimes, unknown to Swiss law, which would make it possible to go beyond compensation for actual loss.

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