THE Banking Litigation Law Review

Fifth Edition

Editor
Deborah Finkler

THE LAWREVIEWS

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PREFACE

This year's edition of the *The Banking Litigation Law Review* highlights that litigation involving banks and financial institutions shows little sign of slowing. The legal and procedural issues that arise in banking litigation continue to evolve and develop across the globe, in the context of both domestic and cross-border disputes.

The covid-19 pandemic continued to loom large in 2021, with judicial systems taking part in a forced experiment of embracing new technology to minimise the disruption caused by pandemic restrictions; in some jurisdictions we may see the permanent adoption of measures taken up in response to the restrictions imposed by the pandemic, as well as a general shift towards the greater use of new technology in dispute resolution. This extends to the increased use of virtual hearings (as well as electronic trial bundles and filing systems), although we can expect that physical hearings will continue to play a prominent role, particularly in complex cases. While it is too early to predict the future with any certainty, it seems likely that some form of hybrid approach is here to stay.

Outside the court room, the effects of the pandemic continue to be felt throughout the wider economy. As various restrictions and financial interventions by governments are scaled back, the early signs of the long-term, negative economic effects of the pandemic are now beginning to emerge in many parts of the world. From the perspective of the financial sector, these conditions are likely to translate into an increase in loan arrears and defaults, debt restructurings, bankruptcies and insolvencies affecting banks, their customers and counterparties. These conditions typically presage an uptick in banking litigation and it seems likely that disputes arising from the economic fallout of the pandemic will feature in future editions of this Review.

A continuing trend this year has been the broadening of obligations placed on financial institutions in the name of improving consumer protection. Faced with the challenge of increasing bank fraud and other illicit transactions, governments and courts alike have continued to develop the nature and scope of duties imposed on banks to protect their customers. Claimants will no doubt continue testing the limits of these obligations and duties in the courts.

Last year's preface highlighted the political and economic uncertainty produced by Brexit as the transition period drew to an end. Since then, some welcome clarity has emerged around the foundations of the United Kingdom's new relationship with the European Union, including in the area of jurisdiction and enforcement of judgments. However, the new relationship will take time to bed down, with additional complexities (and potentially disputes) likely to emerge as parties navigate the new reality. That said, there is little evidence that commercial parties, including banks and financial institutions, have been deterred from choosing the United Kingdom as a forum for litigating their disputes.

While 2021 has been another challenging year for many, there has been some cause for optimism: globally stock markets have continued to perform well as economic recoveries gather pace in many parts of the world, while the roll-out of the covid-19 vaccine has allowed many jurisdictions to emerge from a period of seemingly endless lockdowns and suppressed economic activity. Despite these positive signs, however, the global economy is likely to feel the effects of the covid-19 pandemic for some time and in various (and often unexpected) ways, as highlighted by the recent emergence of a crisis in the global supply chain. At the same time, other global challenges, such as climate change, will increasingly dominate the political and economic agenda. Given the various headwinds and challenges ahead, the high volume and broad nature of litigation in the financial sector look set to continue.

Deborah Finkler
Slaughter and May
London
November 2021

Chapter 9

SWITZERLAND

Nicolas Bracher and Meltem Steudler[1]

I OVERVIEW

Switzerland is a major financial centre. Thus, it does not come as a surprise that there is a considerable amount of case law regarding banking litigation every year. Owing to the traditionally strong wealth management industry in Switzerland, several court decisions in the reporting period deal again with the liability of banks for damage incurred by clients due to unsuccessful investments. Courts have mainly abided by their rigid constant practice in this regard and, in some eminent cases, even raised the hurdle (see below Sections II.i and ii).

Furthermore, in this reporting period, the Swiss Federal Supreme Court handed down a series of new leading decisions concerning claims from clients with regard to unauthorised transactions induced by falsified instructions or of abuse of power of attorneys (see below Section II.iii).

II SIGNIFICANT RECENT CASES

i Substantiation of damages

While proof of the damage is a challenging issue in claims for damages under Swiss law in general, it has become a particularly difficult topic in banking litigation during the past decade. Many claims of clients seeking damages from banks or asset managers related to an alleged defective performance of asset management or advisory agreements are dismissed because the damage is not substantiated in accordance with the law. The difficulties stem from a rigorous constant practice developed by the Federal Supreme Court since the turn of the millennium. Pursuant to this case law, the recoverable damage from defective performance of asset management, advisory or execution only agreements[2] does not equal to the actual loss suffered by the client. Instead, the recoverable damage of the client corresponds to the difference between the worth of the actual assets in which the funds are invested and the worth of hypothetical assets into which the funds would have been invested had there been no breach of duty (e.g., breach of the obligation to inform about the risks of an investment).

Therefore, to prove the recoverable damage in accordance with the law, it is not sufficient under Swiss law to prove the actual losses incurred. Instead, the claimant is forced to devise a portfolio of hypothetical assets ('hypothetical investment/portfolio') that is in accordance with the contract, and to calculate a scenario about the performance of the hypothetical assets over time. Obviously, such calculation is highly complex and will normally require

1 Nicolas Bracher is a partner and Meltem Steudler is an associate at Wenger Vieli AG.

2 Cf. for a characterisation of these three standard agreements BGE 144 III 155.

expert knowledge (which most clients lack). Moreover, proper substantiation and proof of such a hypothetical scenario in court is equally demanding; in particular because the legally relevant scenario depends on several parameters (e.g., relevant part of the invested assets to be taken into account and relevant time period) that are determined by the circumstances of the particular case (e.g., quality of breach, extent of affected assets and characterisation of contractual relationship). Against this backdrop, a claimant is regularly required to set forth and substantiate several scenarios to prove their damage.[3]

In recent years, the presented constant practice of the Federal Supreme Court in this area is criticised by an increasing amount of legal doctrine, including renowned authorities, which point out that the hurdles for claimants seeking damages in this context have become almost insuperable. To date, the Federal Supreme Court has not dealt with these critics. However, in some recent decisions the court has softened its normally rigorous stance under particular circumstances.

In a decision concerning a portfolio management relationship, the Federal Supreme Court seems to have changed its jurisprudence insofar as it has held that in the case where the client claims only compensation for their loss, without claiming compensation for lost profit, the portfolio manager bears the burden of proof that the loss would have occurred even without a breach of duty.[4] The important practical consequence of this is that the client is not obliged to devise the scenarios described above but can simply prove the loss suffered, if they do not seek damages for lost profit.

However, in that same decision, the court also made it clear that this does not apply for investment advisory relationships. Instead, pursuant to the court in the context of an investment advice relationship, it is assumed that the client wishes to make investments and that the client would have invested in other financial instruments if they had received investment advice in accordance with the contractual duties of the investment adviser. Only if the client can prove that they would not have invested at all had they been advised correctly can the damage be equated with the loss. In the jurisprudence of the Federal Supreme Court such cases are rare.[5]

All the more remarkable, therefore, is another recent decision of the Federal Supreme Court concerning an investment advice relationship in connection with investments in a cum-ex fund, in which the court ruled that the damage of the client equated to its loss and applied the 'passive hypothesis'.[6]

The lower court, the Commercial Court of Zurich, had affirmed a breach of duty with regards to the advice given by the bank, as it had made deceptive statements to the client, a real estate company, about the risk of investing in the fund. Nevertheless, the Commercial Court dismissed the claim for damages because the client had not explained what alternative investments it would have made if it had not invested in the fund.

The client filed an appeal to the Federal Supreme Court that overruled the decision of the Commercial Court of Zurich. The Federal Supreme Court assumed that the client would have refrained from investing if it had been informed correctly about the risks of the fund. The client had thus far invested exclusively in real estate. The purchase of the fund units was

3 BGer 4A_202/2019 dated 11 December 2019.
4 BGer 4A_449/2018 dated 25 March 2019.
5 C.f. BGE 124 III 155.
6 BGer 4A_297/2019 dated 29 May 2020.

a test run with a short-term period, after the expiry of which one could, if necessary, decide to make further investments based on the experience gained. Therefore, the Federal Supreme Court obliged the bank to reimburse the purchase price and the client to repay the fund units.

Notably, the decision was made taking into account the fact that there had been no prior business relationship between the parties and the purchase of the fund units was the client's first investment in the financial market. Therefore, considerations of the decision cannot be unreservedly generalised.

ii Restitution in kind

Another way to ease the very demanding requirements of the substantiation of the damages is restitution in kind.

According to Swiss statutory law, the judge determines the type of damages, so that in addition to monetary damages, damages in kind or a combination of both is possible. In practice, damages are usually awarded in the form of money. Restitution in kind, however, is granted very rarely.

If restitution in kind is awarded, the tortfeasor must restore the situation that would have existed without the breach of duty. Restitution in kind is not to be confused with rescission, since it is not necessary to restore the situation that existed before the damage was inflicted. Instead, the injured party is to be put in the situation in which they would have been without the breach of duty. For example, according to a long-standing practice of the Federal Supreme Court, it is possible to oblige the tortfeasor to take over the shares of the injured party, even if they did not sell them themselves.[7] In banking transactions, a restitution in kind makes sense in cases where it is not possible to calculate the damage because the investment has no market value, such as an investment fund that is being liquidated due to irregularities, so that liquidation proceeds are uncertain.

In the recent decision already mentioned above,[8] the Federal Supreme Court granted the client restitution in kind in such a way that it obliged the bank to pay the client the invested amount of money back in exchange for the financial instruments purchased by the client. However, in a decision rendered only four months after this Federal Supreme Court decision, the Commercial Court of Zurich held in a comparable case that a restitution in kind was not suitable in investment damage cases.[9] Considering these two recent decisions, whether a restitution in kind still remains an exemption is unclear.

In addition, there is a practical problem. It is at the discretion of the court whether to award monetary or restitution in kind. Since the judge decides on the type of compensation, the claimant cannot assume that they will also receive compensation in kind. Therefore, the client not only can claim restitution in kind, but also must assert and prove the concrete amount of damages and at least demand monetary compensation in the contingent claim.

iii Unauthorised transactions

A recurring topic in banking litigation is unauthorised transactions. Bank accounts are a popular target for criminals. A major gateway has always been the communication between bank and client in the context of payment transactions. To protect themselves from criminal

7 BGE 99 II 176; BGE 41 II 77.

8 BGer 4A_297/2019 of 29 May 2020.

9 Decision of the Zurich Commercial Court HG180163-O of 7 September 2020.

activities, banks agree with their clients on means of identification by which the client or their representatives must prove to the bank that they are the authorised persons. Such means of legitimation are the signature of the client, passwords and access codes for e-banking, e-mails and – for representatives of the client – bank powers of attorney, among others. Forgery or misuse of means of identification is not uncommon in banking practice. If this causes damage, the question arises as to whether the bank or the client must bear this damage.

On the basis of its constant practice in this regard, the Federal Supreme Court clarified further important questions in several published leading decisions in the reporting period. Pursuant to these decisions, Swiss courts must apply a three-step test to decide whether the bank or the client bears the loss arising from an unauthorised transaction.[10]

First, for the client's main action for restitution of their credit balance that has not been reduced by undue debits (Article 107, Paragraph 1 of the Swiss Federal Code of Obligations (CO)), the judge must examine whether the debits were carried out with or without a mandate from the client, which presupposes, in the case of representation of the account holder, that the question of the representative's powers or of the account holder's ratification of the debits must be addressed.[11] In banking transactions, the bank may, in principle, rely on the means of legitimation agreed with the client. In particular, it does not have to systematically assume forfeitures. As a rule, the principal who notifies the power of attorney that has been granted to an agent, to a third party in writing, is bound by the legal act performed by the agent, if the act falls within the scope of the written power so notified. Furthermore, the client must also accept transaction orders issued by telephone, e-mail or fax, provided that they have consented to these communication channels and means of legitimation. In principle, the client bears the risk of forged or abusive transactions, provided they are covered by a power of attorney or an agreement with the bank regarding the permissible means of identification. However, the bank cannot rely on an agreed means of identification if it recognises its forgery (e.g., forged signature; e-mail from an unauthorised person) or misuse (e.g., authorised representative enriches themself without authorisation) or should have recognised it within the scope of its duty of care. Therefore, in the case of unusual orders, the bank must consult with the client before executing them.

In a recent leading decision, the Federal Supreme Court clarified that the need for rapid processing of payment transactions does not constitute a reason to restrict the duty of care in banking transactions. In addition, the bank cannot reduce its due diligence requirements by formulating the power of attorney forms accordingly. Increased due diligence requirements apply if the transaction drains the bank client's account to a large extent or if the bank is in a conflict of interest. An example of the latter is if the bank has granted a loan to the authorised representative who misuses the power of attorney granted to them for payments in their favour.[12]

If a transfer is made without the client's order, the transfer does not constitute fulfilment of the contract in relation to the client. The client may therefore still demand payment of the corresponding amount. On the one hand, this applies if the bank carries out a transaction without being able to rely on a contractually agreed means of legitimation. For example, e-mails or scans and faxes with copied signatures are only means of legitimation if this is

10 BGE 146 III 121; q.v. BGE 146 III 326; BGE 146 III 387; BGer 4A_616/2019 of 17 April 2020; BGer 4A_161/2020 of 6 July 2020.

11 BGE 146 III 121; BGE 146 III 387.

12 BGE 146 III 121.

contractually agreed upon between the bank and the client.[13] On the other hand, the contract is also not fulfilled if the bank has not recognised the forgery or misuse of an agreed means of identification by a third party due to a breach of its duty of care. According to the established case law of the Swiss Federal Supreme Court, it is therefore not the client but the bank that suffers a loss in these cases. This applies in principle even if the bank cannot be accused of any fault and has made a payment in good faith to a fraudster.

Only if the orders were executed without a mandate from the client does the judge have to examine, in a second step, whether the damage is a damage of the bank (legal system) or whether, due to the conclusion of a risk transfer clause, the damage is borne by the client.[14] In banking practice, the risk of double payment for banks resulting from the legal system is regularly avoided by way of specific risk transfer clauses in the bank's general terms and conditions. In these clauses, it is agreed that in the event of an incorrect transfer, the client, and not the bank, must bear the damage, unless the bank itself has acted with gross negligence. Gross negligence is assumed if the most elementary care is violated; that is, the bank disregards very serious, almost obvious indications of forgery or misuse. According to the Federal Supreme Court, such risk transfer clauses are generally permissible.

If the bank bears the loss in the case of incorrect transfers because no risk transfer clause was agreed or such a clause does not apply due to gross negligence on the part of the bank, the bank may, under certain circumstances, counter the client's claim for performance with a claim for damages. Therefore, in a third step, it must then be determined whether the client has contributed to the occurrence of the loss or to its increase by a breach of duty. In several recent decisions, the Federal Supreme Court pointed out that such a breach of duty may lie in the fact that the client does not check their bank correspondence in a timely manner.[15] The banks' general terms and conditions often stipulate that the client must check their account statements and complain about unusual or unjustified transactions within a short period of time. In its more recent case law, the Federal Supreme Court has derived from this complaint clause, which is customary in the industry, a duty of care on the part of the client to check communications from the bank in a timely manner to prevent losses from incorrect bookings and unauthorised transactions. This applies even in those cases in which correspondence is held by the bank based on a hold-mail agreement.

In one of these recent decisions, the Swiss Federal Supreme Court had the opportunity to discuss in more detail the bank client's duty of care. It specified that the bank must prove the following in order to assert its claim for damages arising from a breach of this duty of care by the client. First, the bank documents showing the unauthorised transactions must actually have been delivered to the client or stored by the bank in case of hold-mail arrangements. Second, the documents must be designed in such a way that the client would have been able to identify the unauthorised transactions if they had inspected the documents. Depending on the context, the false entries must immediately catch the eye.[16] This issue is likely to continue to be a topic in the practice of the courts, as a number of relevant questions remain open.

13 BGE 146 III 387; BGer 4A_9/2020 of 9 July 2020.
14 BGE 146 III 121; BGE 146 III 387.
15 BGE 146 III 12; 4A_161/2020 of 6 July 202; 4A_337/2019 of 18 December 2019.
16 BGer 4A_337/2019 of 18 December 2019.

iv Retrocessions

The Swiss Federal Supreme Court already decided in 2006 that retrocessions must be handed over to the client.[17] In further decisions, the Swiss Federal Supreme Court specified its jurisprudence. According to case law, clients might waive their right to receive the retrocessions. However, the financial service provider must inform the client in advance about the amount of retrocessions.

For a waiver of restitution in advance to be valid, the client must be aware of the parameters that allow the overall amount of the retrocessions to be calculated and make a comparison possible with the fees agreed for the asset management. In other words, the waiving client must be able to compare the amount of these retrocessions with the agreed asset management fee in order to know how much their agent will ultimately receive. The expected retrocessions must therefore be stated as a percentage of the assets under management within a certain range.[18]

In a recent decision, the Federal Supreme Court confirmed this jurisprudence and clarified that it is not sufficient if only the percentage range of the individual product categories is shown. Such a clause only allows for the calculation of retrocessions related to specific investments, but it does not provide any indication that could inform the clients, in the absence of any investment (at the beginning of the contractual relationship), on the total amount of retrocessions that could be received based on a given percentage of their assets under management.[19]

v Negative interest rates and LIBOR

In the context of bank loans, the parties often fix an indexed interest rate with a variable rate (e.g., London Interbank Offered Rate (LIBOR) or Euro Interbank Offered Rate (EURIBOR)), so that the calculation of the contractual interest is based on the conditions of the market. In principle, this variable rate, which is considered an index, is joined by a fixed rate, generally referred to as the margin, which the bank reserves for itself as compensation and as consideration for the credit risk assumed. The fall of the reference rate into negative values can lead to a complete negative rate in application of the margin agreed by the parties to such a loan.

In a decision from 2019, concerning a LIBOR loan, the Swiss Federal Supreme Court ruled that the obligation to pay interest in loan agreements could only be reversed if this was explicitly stipulated in the contract. In other words, the lender is not obliged to pay negative interest rates to the borrower, unless the parties have agreed on this.[20] However, the Swiss Federal Supreme Court left the question open as to whether the agreed margin is reduced by a negative LIBOR, so that the required interest can drop to zero.

In a case recently heard by the Zurich High Court, the parties' dispute specifically revolved around the question of whether a negative LIBOR is reflected in the interest to be paid and reduces the agreed margin, as the client claimed, or whether this value never becomes negative and, in the case of a negative LIBOR, the interest calculation is always based on a base value of zero (zero interest floor or LIBOR-0%-floor), so that the margin is always owned in full, as the bank in this case argued.

17 BGE 132 III 466.
18 BGE 137 III 393.
19 BGer 4A_355/2019 of 13 March 2020.
20 BGE 145 III 241.

The client demanded the reimbursement of the interest wrongly charged by the bank in their opinion. The bank countered that the client did not protest against the minimum base rate (the base rate is always at least zero) mentioned in the product confirmation letter and paid the mortgage interest without reservation and therefore agreed to it.

The Zurich High Court denied such an effect of the product confirmation letters. It ruled that whether the client must pay the bank the margin as mortgage interest, even in the case of a negative LIBOR, is a disputed question of fact. Therefore, the lower court should have conducted a trial of evidence, which it failed to do. For this reason, the case was remanded to the lower court.[21]

III RECENT LEGISLATIVE DEVELOPMENTS

On January 2020, the Financial Services Act (FinSA) entered into force together with the Financial Institutions Act (FinIA). While the FinIA lays down authorisation requirements and other organisational requirements applicable to financial institutions, as well as their supervision, the FinSA stipulates uniform regulatory provisions on the provision of financial services and the offering of financial instruments. The FinSA is a regulatory framework whose content is specified in greater detail in the Financial Services Ordinance (FinSO or the Ordinance). Many obligations set out by the FinSA and, thus, are now stated in regulatory law, have already existed based on civil law and, for regulated financial market participants, have also been based on the relevant Swiss Financial Market Supervisory Authority (FINMA) requirements.

This means that there are now parallel regulatory and civil duties of conduct and organisational requirements, although their content is not completely identical. For example, there is no differentiation between transaction- and portfolio-related investment advisory in civil law. The extent of assessment and disclosure requirements under civil law depends on the circumstances of each individual case. Another example is the duty to assess the suitability of an investment based on the client's financial situation and investment objectives as well as their knowledge and experience. In a recent decision, the Federal Supreme Court confirmed that, from a civil law perspective, a suitability test is necessary for all investment advisory relationships.[22] According to the FinSA, however, a suitability test is required only for retail clients and not for professional clients.

The comprehensive regulatory adoption of investor protection provisions under the FinSA and the FinSO is expected to have relevant effects on civil liability. This is especially the case where the detailed stipulation of regulatory obligations affects the parallel civil obligations of financial service providers and makes those more concrete. This most likely occurs when it comes to disclosure requirements and organisational rules, which might lead to an increase in liability risks.

Yet the question might occasionally arise as to what extent regulatory exemptions must also be considered under civil law. What needs to be clarified, for example, is whether and to what extent a client's advance waiver of disclosure requirements or a limited suitability test as provided under the FinSA for professional clients is also permissible for the parallel civil disclosure and assessment requirements. Until this has been clarified, scenarios like these

21 Decision of the Zurich High Court LB200029-O/U of 19 January 2021.

22 BGer 4A_519/2021 of 15 February 2021.

will involve civil liability risks, in particular if the classification of the client is based on an opting-out clause, and the client only opted out because of both the scope of their assets and their lack of knowledge and experience.

IV CHANGES TO COURT PROCEDURE

On 1 January 2011, the Swiss Civil Procedure Code came into force. Before this, Swiss civil procedures were governed by cantonal law as each canton had its own Code of Civil Procedure (the same was true for penal procedure). While the uniformity of the court proceedings in all cantons was a positive change, many hurdles regarding litigation remain, mainly in relation to the costs of litigation.

On 26 February 2020, the Swiss Federal Council published a report and a draft bill concerning the revision of the Swiss Civil Procedure Code. The aim of the revision is to facilitate the access to court and thus the enforcement of rights in private law.

In particular, the cost barriers and the litigation cost risk are to be lowered. The changes in this regard are the following. The claimant shall, as a rule, only advance half of the full expected court costs, which is opposed to today's rule where the court can oblige the claimant to advance the full expected court costs. If the respondent loses the proceedings, they have to reimburse the successful claimant for the court fees. However, under the current regime, the successful claimant bears the collection risk. The draft bill provides that the collection risk for the court costs shall shift from the successful claimant to the state.

A rather controversial proposal is the extension of the right to refuse to cooperate in civil proceedings. Nowadays, in-house legal counsels do not have such a right. The draft bill intends to grant this privilege not only to attorneys, but also to in-house legal counsels.

Furthermore, the Swiss Federal Council proposes an optional conciliation procedure in cases heard by the commercial courts. In principle, before initiating civil proceedings, the parties must undergo a conciliation procedure. The compulsory conciliation procedure is waived, inter alia, if a commercial court has jurisdiction.

Finally, the draft bill gives the cantons the possibility to establish international commercial courts. English can be recognised as the language of proceedings. Notably, the commercial court of Zurich already accepts documents in English; however, submission must be made in German.

In the original draft bill of the Federal Council, there were also measures to improve collective redress. As these were very controversial, the Federal Council has decided to address them in a separate legislative process.

The draft bill is now discussed by the Swiss Parliament. The Council of States adopted the Federal Council's bill with some additions and amendments. One important amendment is the possibility of the court to allow persons to participate in oral procedural acts by means of electronic instruments.

The revision of the Swiss Civil Procedure Code is expected to come into force in 2023, at the earliest.

V OUTLOOK AND CONCLUSIONS

The end of the LIBOR brings an increased risk for legal disputes. LIBOR is frequently used as the base interest rate in loan agreements (including mortgage loans) and derivative contracts. Unless a fall-back clause has already been implemented in existing contracts, it is unclear on what the basis interest is to be calculated in the future with the discontinuation of LIBOR. Therefore, from 2022 onwards, there will be considerable uncertainty with regard to the interest rate.

A certain degree of legal uncertainty also exists when it comes to the relationship between the contractual and regulatory duties of financial service providers, as both contract law and the FinSA set forth duties of financial service providers. In the future, disputes that revolve around the discrepancies between the contractual and regulatory duties can thus be expected.

Appendix 1

ABOUT THE AUTHORS

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