Finance Law: The Relationship between Private Law and Regulation

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Abstract

This thesis argues that bank customers need legal protection to be impurely paternalistic given their behavioural biases, weaker position and vulnerability, banking services' necessity, financial exclusion risk and banks' misconduct. The thesis argues that the current legal and regulatory framework fails to adequately provide such protection and provides reasons therefor. The thesis contends that a synthesis of private law and financial regulation is required to form a coherent system of finance law which would furnish adequate protection. The thesis claims that this is possible through primary legislation which would impose a statutory general fiduciary duty on banks to customers. The thesis asserts that such a duty should include the duty to advise. The duty to advise would require banks to consider the customer's existing personal circumstances and, accordingly, provide tailored advice to maintain or improve their welfare.

The thesis further argues that the statutory fiduciary duty would provide adequate protection because it would furnish the kind of impure paternalism required. It would also provide proper both *ex ante* protection, at the moment the contract is concluded, and *ex post* protection, throughout the contract's life span. The thesis affirms that such a duty would therefore protect the welfare of customers throughout the whole duration of their relationship with banks, which relationship may experience life-changing situations. Finally, the thesis recommends a realistic and plausible method of implementing the statutory fiduciary duty, namely, by public funding of costs of litigation against banks by the Financial Conduct Authority. The statute establishing the fiduciary duty would empower the Financial Conduct Authority to finance litigation costs both to customers who intend to institute proceedings individually and to those who intend to represent others in class actions. The thesis also claims that a narrow degree of wealth redistribution is required to avoid financial exclusion of customers by compelling banks to provide their basic services to all customers, given the public utility nature of such

services, and to prevent customers from paying the costs of banks' regulation, supervision and litigation against banks by imposing such costs on banks themselves.

Dedicated to the loving memory of my dear dog Kristal, who passed away on 25 April 2022

Will never be forgotten and always be missed

Until we meet again at the Rainbow Bridge

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List of Abbreviations

Business to consumer: B2C

Competition and Markets Authority: CMA

Consumer Rights Act 2015: CRA 2015

Consumer Credit Act 1974: CCA 1974

Consumer Protection from Unfair Trading Regulations 2008: CPUTR 2008

Department for Business, Innovation and Skills: BIS

European Union: EU

Financial Conduct Authority: FCA

FCA's Banking Conduct of Business Sourcebook: BCOB

FCA's Conduct of Business Sourcebook: COBS

FCA's Mortgages and Home Finance Conduct of Business Sourcebook: MCOB

FCA Consumer Credit Sourcebook: CONC

Financial Ombudsman Service: FOS

Libor Interbank Offered Rate: LIBOR

Office of Fair Trading: OFT

Payment Protection Insurance: PPI

Retail Distribution Review: RDR

Financial Advice Market Review: FAMR

Unfair Contract Terms Act 1977: UCTA 1977

Unfair Terms in Consumer Contracts Directive: UTCCD

Unfair Terms in Consumer Contracts Regulations 1999: UTCCR 1999

United Kingdom: UK

United States: US

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Chapter One

Introduction

1.1 Introduction

In recent years, a string of scandals affecting consumers of financial services were observed to the extent that the word 'scandals' came to be analogous with banks. Following the Global Financial Crisis in 2007-2008, prominent banks were identified to be engaging in broad-scale misconduct to enhance profits and minimise costs.[1] The scandals have involved a variety of products and practices. However, low-quality products, improper staff bonus plans and relentless sales-based attitudes were major fundamental drivers. Scandals included mis-selling of Payment Protection Insurance policies,[2] investment products, advice, packaged bank accounts and mortgages, Consumer Credit Act 1974 breaches[3] and the London Interbank Offered Rate rigging.[4]

[1] George Tchetvertakov, 'UK Bank & Scandals: A Match Made in Heaven' (31 January 2015) <https://magazine.moneytransfercomparison.com/uk-banks-overview/> accessed 4 April 2022.
[2] Frances Coppola, 'The U.K.'s Biggest Financial Scandal Bites Its Biggest Bank – Again' (31 July 2019) <www.forbes.com/sites/francescoppola/2019/07/31/the-u-k-s-biggest-financial-scandal-bites-its-biggest-bank-again/?sh=2ec6384a7e20> accessed 4 April 2022.
[3] Dominic Lindley, 'The top 10 retail banking scandals: 70 billion reasons why shareholders must play a greater role in changing bank culture' (*New City Agenda*, 11 April 2016) <https://newcityagenda.co.uk/the-top-10-retail-banking-scandals-50-billion-reasons-why-shareholders-must-play-a-greater-role-in-changing-bank-culture/> accessed 4 April 2022.
[4] Liam Vaughan and Gavin Finch, 'LIBOR Lies Revealed in Rigging of $300 Trillion Benchmark' (*Bloomberg*, 6 February 2013) <www.bloomberg.com/news/articles/2013-01-28/libor-lies-revealed-in-rigging-of-300-trillion-benchmark> accessed 4 April 2022.

1.2 Research question and sub-questions

Law is composed of legal principles. Finance law in the United Kingdom (UK) is made up of private and public law. The private law sphere of finance law comprises contract law, tort law, property law and equity, primarily fiduciary law and trusts. The public law sphere consists of finance statute, primarily the Financial Services and Markets Act 2000 and its accompanying legislation, and financial regulation. Hence, finance law encompasses all these different types of laws and regulation.[5] Moreover, the expansion of consumer protection legislation can significantly alter the private law environment. Such legislation aims to improve consumer access to justice by providing a streamlined and unambiguous set of rights and remedies. However, by doing so, they may underestimate or substitute established contractual principles, thereby affecting fundamental private law rights and remedies. Consequently, an incoherent private law system could emerge, having diverse concepts and rules governing business and consumer activities.[6]

Nevertheless, the private law and statutory systems function so closely that it is possible that they develop in unison. Therefore, a more unified and cohesive consumer protection law that draws from both statutory and private law may gradually evolve.[7] Additionally, private law and financial regulation principles are indeed integrating together to generate finance law principles, and this should be encouraged.[8] Within this framework, banks' legal treatment is a mix of private law transactions and public law amid financial regulation between banks and customers. Thus, it is argued that finance law necessitates a

[5] Alastair Hudson, *The Law of Finance* (2nd edn, Sweet and Maxwell 2013) para 4-06.
[6] Elise Bant and Jeannie Marie Paterson, 'Consumer Redress Legislation: Simplifying or Subverting the Law of Contract' (2017) 80(5) Modern Law Review 895.
[7] ibid.
[8] Hudson (n 5) para 3-3.

synthesis between these two legal systems[9] to provide adequate protection to bank customers.

To this end, this thesis will investigate whether it is really necessary to harmonise, or synthesise, private and regulatory law to provide a coherent system of finance law for adequate bank customer protection. While investigating this research question, the thesis will explore *inter alia* sub-questions relating to the adequacy of protection afforded by each area of existing law, principally, contract law, statutory consumer law, tort law and financial regulation. In answering the research question, the thesis will elaborate a method of synthesising private law and financial regulation, namely through a statutory fiduciary duty, which should be owed by banks to their customers.[10] The thesis will interrogate whether such a duty would provide adequate bank customer protection, that is, whether it would convey the proper legal paternalistic protection required and furnish both *ex ante* protection, at the moment of contract conclusion, and *ex post* protection, beyond contract conclusion and throughout the contract's duration. This is crucial to the welfare of customers throughout their relationship with banks and, ultimately, throughout their lives.[11]

1.3 Scope

This thesis focuses on the relationship between a bank and retail customer, who is an individual, a natural person, and, therefore, qualifies under consumer protection law as a consumer. Hence, it is not concerned with businesses, or legal persons. A bank is defined

[9] Alastair Hudson, 'The Synthesis of Public and Private in Finance Law' in K Barker and D Jansen (eds), *Private Law: Key Encounters with Public Law* (Cambridge University Press 2013).
[10] Ruth Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' in Costanza Russo, Rosa Lastra and William Blair (eds), *Research Handbook on Law and Ethics in Banking and Finance* (Edward Elgar Publishing 2019) 214.
[11] Iris H-Y Chiu, Andreas Kokkinis and Andrea Miglionico, 'Addressing the challenges of post-pandemic debt management in the consumer and SME sectors: a proposal for the roles of UK financial regulators' (2 October 2021) Journal of Banking Regulation <https://doi.org/10.1057/s41261-021-00180-2> accessed 18 February 2022.

as ‘a UK institution which has permission under Part 4A of the Financial Services and Markets Act 2000 to carry on the regulated activity of accepting deposits’.[12] A retail customer is ‘an individual who is acting for purposes which are outside his trade, business or profession’.[13] A consumer is defined as ‘an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession’,[14] or, similarly, ‘any natural person acting for purposes outside his trade, business or profession’.[15] The terms ‘customer’ and ‘consumer’ will be used interchangeably throughout the thesis.

Thus, the thesis is concerned with the real-life context of individuals dealing with banks. The development of a fiduciary duty for banks would take cognisance of the fact that individuals rely on financial services throughout their life cycle due to increasing financialisation. Depending on their life situation, this could include a range of financial services, such as mortgage and consumer loans or the provision of investment opportunities. The use of these services is now an inevitable part of daily life.

1.4 Methodology

The thesis adopts a mixed-method approach. It is a mix of doctrinal legal analysis, comparative legal analysis and normative analysis. The main method is doctrinal legal analysis. The other two are supplementary ones. Comparative legal analysis is mainly carried out with Israel. Normative analysis is performed drawing on theoretical and empirical studies. Statutes, cases, books, journal articles, regulatory and other policy documents, theoretical and empirical academic studies have been used. Empirical methods, such as interviews, have not been applied because the main focus of the thesis is not how banks and customers perceive the current regime. Instead, the thesis has

[12] Banking Act 2009, s 2(1).
[13] FCA Handbook, glossary.
[14] Consumer Rights Act 2015 (CRA 2015) s 2(3).
[15] FCA Handbook, glossary.

identified a problem with the law itself and deals with how to actually improve it. Therefore, the methods utilised have been appropriate to answer the research question and subsidiary ones. It was not necessary to conduct original empirical research or focused groups.

1.5 Original contribution

Building on other academics' work, the thesis proposes a way forward for a synthesis of private law and financial regulation to form a coherent system of finance law to provide the necessary impure paternalism and, hence, furnish adequate *ex ante* as well as *ex post* bank customer protection. The thesis goes further than what other academics have suggested, namely, the synthesis of the two legal systems,[16] the proposal of a statutory general fiduciary duty, which does not incorporate the duty to advise,[17] the recommendation of impure paternalism[18] and the provision of *ex ante* and *ex post* protection.[19] The thesis combines these four arguments together and further recommends that a statutory general fiduciary duty would achieve the required synthesis of law. The statutory fiduciary duty would include a duty to advise, which would require banks to consider the existing customer's personal circumstances and, accordingly, provide tailored advice to maintain or improve their welfare. Moreover, the thesis furnishes recommendations of what the relevant new statute should include. It also provides a realistic way of implementing such a statutory general fiduciary duty, namely, by public funding by the FCA. Additionally, although the main argument of the thesis advocates impure paternalism, it proposes a restricted form of wealth redistribution in specific contexts, namely, to eliminate the risk of financial exclusion of bank customers by compelling banks to provide their basic services to all customers and to prevent

[16] Hudson, 'The Synthesis of Public and Private in Finance Law' (n 9).
[17] Plato-Shinar (n 10).
[18] Iris H-Y Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (2021) 41 Legal Studies 657.
[19] Chiu and others (n 11).

customers from paying expenses of banks' regulation and supervision, and litigation against banks by inflicting these expenses on banks themselves.

1.6 Caveats

The thesis is concerned with banks and natural persons as bank customers. It excludes legal persons from the analysis. Further, it looks at consumer protection from the private law and public law perspectives. It does not take cognisance of competition law. Additionally, it does not consider property law and criminal law, both of which also form part of private law and contribute to consumer protection.

1.7 Overview of chapters

This first chapter will seek to demonstrate the significance of the thesis, identify the research question and sub-questions, clarify the scope, explain the methodology used, certify the original contribution, discern caveats and furnish a brief overview of the seven chapters constituting the thesis.

The second chapter will seek to demonstrate that notwithstanding that bank customers are free to negotiate and deal with their banks, they require legal protection therefrom. The chapter will discuss the three different rationales for customer protection, namely, market efficiency, paternalism and redistribution of wealth, which rationales confer different degrees of protection. The chapter will seek to argue that customers need the law to be impurely paternalistic for various reasons. The chapter will discuss these reasons, which are consumers' behavioural biases, weaker position and vulnerability, the essentiality of banking services and risk of financial exclusion, and banks' misconduct. Furthermore, the chapter will claim that wealth redistribution is required limitedly in particular contexts, precisely to avoid customers' financial exclusion and to ascertain that

banks themselves pay for their regulation and supervision.

The third chapter will explore the extent to which the common law of contract protects bank customers and will seek to argue that such law fails to protect them adequately. It will argue that it practically endorses freedom of contract and fails to provide the kind of impure paternalism advocated in Chapter Two. It will further claim that the common law of contract essentially affords limited *ex ante* protection. The chapter will identify the reasons as to why this is so. It will contend that common law commences from the proposition that the bank-customer relationship is an arm's length relationship wherein both parties are capable of protecting themselves and banks owe no general fiduciary duty to customers.[20] The chapter will seek to argue that proof thereof are the following: the bank-customer relationship is basically a commercial, contractual and debtor-creditor one; the law respects autonomy and freedom of contract and insertion of exclusion of liability and variation clauses in contracts are allowed; banks do not owe a general duty of reasonable skill and care to customers; banks have no duty to advise unless this is specifically agreed with the customers; and banks can contract out of their implied duty of confidentiality or are allowed to disclose information provided prior consent from customers is obtained. The chapter will also seek to contend that two essential common law rules, which intrude with freedom of contract, namely, the doctrine of undue influence and the penalty rule, are flawed. The chapter will further argue that although courts may provide a degree of *ex post* protection, they are hesitant to hold banks liable under a contractual duty of care.

The fourth chapter will analyse to what extent two main consumer protection statutes, namely, the Consumer Rights Act 2015 (CRA 2015) and Consumer Credit Act 1974 (CCA 1974), do protect bank customers as consumers of banking services. The chapter will seek to argue that these two statutes fail to provide adequate protection to consumers. The chapter will contend that whereas they favour freedom of contract less than the

[20] Chiu and others (n 11).

common law of contract and take a more paternalistic stance than this type of law, they fail to provide the impure paternalism proposed in Chapter Two. Furthermore, the chapter will argue that, together, the two statutes basically furnish a restricted degree of *ex ante* and *ex post* protection. The chapter will contend that some provisions of these statutes, particularly the CRA 2015's unfair terms provisions and CCA 1974's unfair relationships provisions, are lengthy, difficult to comprehend and unpredictable.[21] The chapter will argue that while the CRA 2015's assessment criteria are comprehensive as they take cognisance of the contract's nature and circumstances, and have a broad scope as they are applicable to all types of consumer contracts, they simply evaluate whether the individual terms imposed were unfair. Moreover, the chapter will argue that the relevant CRA 2015's provisions are not applicable to the fairness of the contract's main terms or the price's appropriateness when such terms are transparent and prominent.[22] The chapter will further contend that, contrastingly, the CCA 1974's unfair relationships sections empower a court to consider individual terms and how the bank has used or enforced a right under the agreement or associated agreement, or any other thing carried out, or not carried out.[23] Additionally, the relevant CCA 1974 requirements are applicable to the contract's essential terms. However, they are narrow in scope because they only apply to credit agreements.[24]

The fifth chapter will seek to identify the extent to which tort law protects bank customers. The chapter will further seek to contend that tort law does not furnish adequate protection because it promotes freedom of contract, even more than the common law of contract, and practically takes the same degree of paternalistic approach to bank customer protection as this type of law, thereby also failing to furnish the impure paternalism advanced in Chapter Two. The chapter will argue that tort law only provides *ex post* protection. The chapter will analyse and will seek to demonstrate various pitfalls in the

[21] Emmanuel Sheppard, 'The court's discretion to determine unfair relationships: new guidance' (2019) 34(10) JIBFL 680; Paul Skinner, 'Caveat creditor: difficulties in unfair relationship claims (2015) 30(9) Journal of International Banking and Financial Law 555.
[22] CRA 2015, s 64(1).
[23] CCA 1974, ss 140A-140D.
[24] Chiu and others (n 11).

tort of deceit, the tort of negligence generally, the tort of negligent misstatements, the relationship between tort and contract, and the Misrepresentation Act 1967 (MA 1967). The chapter will also argue that a fraud claim requires thorough evidence, which is hard to attain, and is discovered after it is too late to do anything as the transaction will have been concluded. The chapter will further seek to contend that banks do not owe a general tortious duty to exercise reasonable care and skill to avoid pure economic loss to customers and do not owe a tortious general advisory duty either. Additionally, the chapter will claim that the MA 1967 provides inadequate protection as it only furnishes a restricted degree of *ex post* protection due to its clumsy drafting and especially in providing that banks making an innocent misrepresentation that induces others to enter into a contract consequent to which the latter suffer loss are liable as if the misrepresentation was carried out fraudulently. Moreover, the chapter will argue that while English courts may furnish a certain degree of *ex post* protection, they are reticent to hold banks liable for a tortious duty of care or for having furnished no advice or rendered negligent advice to customers.

The sixth chapter will seek to investigate the degree of protection granted by the UK's Financial Conduct Authority (FCA)'s regulatory regime to bank customers. The chapter will seek to argue that this regime also provides inadequate protection because, although it is the framework which least promotes freedom of contract, it nevertheless fails to provide the impure paternalism acclaimed in Chapter Two. The chapter will demonstrate that the regulatory regime essentially furnishes limited *ex ante* protection and practically no *ex post* protection. The chapter will contend that this is evident from deficiencies present in the FCA's Handbook, powers, consumer redress, approach to protecting consumers and the new Consumer Duty. The chapter will also seek to argue that the Financial Ombudsman Service (FOS) provides limited protection because while bank customers may seek *ex post* redress, it is questionable whether this is actually provided when no point of sale problems are present and the FOS is not bound by precedent. Furthermore, the chapter will seek to contend that, whilst English courts may provide a degree of *ex post* protection, they are hesitant to recognise that the regulatory rules provide positive private law obligations on banks.

The seventh chapter will seek to analyse what kind of reform is necessary to provide adequate protection to bank customers. The chapter will seek to argue that a synthesis of private law and financial regulation is required to form a coherent system of finance law that will provide the type of impure paternalism upheld in Chapter Two and, therefore, render adequate bank customer protection. The chapter will propose and contend that this is possible through primary legislation which would impose a statutory general fiduciary duty on banks to their customers. The chapter will further assess the kind of fiduciary duty that should be furnished in order to render the necessary protection which the common law of contract, statutory consumer law, tort law and the regulatory regime cannot provide. The chapter will seek to argue that a general statutory fiduciary duty would provide adequate protection because it would furnish the type of impure paternalism upheld in Chapter Two and furnish both *ex ante* and *ex post* protection. The chapter will further seek to claim that such a duty would protect the welfare of customers throughout the whole duration of their relationship with banks, during which customers may experience unfortunate life-changing events.

The chapter will also seek to pre-empt and rebut counter arguments to the proposal made. Finally, the chapter will seek to recommend a realistic and plausible method of implementing the statutory fiduciary duty, namely, by public funding by the FCA. The chapter will provide details as to what the statute should include to make this workable. The chapter will also acknowledge that whereas the crucial argument of the thesis is that a type of impure paternalism is necessary to provide adequate bank customer protection, a narrow form of wealth redistribution is required in specific contexts. Thus, the chapter will argue that wealth redistribution is needed to avoid financial exclusion of customers and therefore, will argue that banks should be obliged to offer basic services to all customers given the public utility nature of their services. The chapter will further contend that wealth redistribution is essential to prevent customers from paying for the costs of banks' regulation and supervision, and costs of litigation against banks and, hence, will claim that banks should finance the FCA's public funds, which would be used to cover customers' costs of litigation against banks.

The final chapter will group all the conclusions drawn in the other chapters. It will also suggest future research, possibly on bank customers that are legal persons, and on consumer protection, primarily, from competition law perspective but also from property law and criminal law end.

1.8 Conclusion

This chapter provides an outline of the whole thesis, which will consider bank customer protection from the private law and financial regulation perspectives. It is to be noted that competition law is integral to a holistic consumer protection because at the end of the day, how much consumers will fare in any industry depends primarily on how competitive the industry is. Hence, ensuring effective competition is of paramount importance but it is not the scope of this thesis.

Chapter Two

The Necessity of Legal Protection for Bank Customers: enabling Free Choice vs Paternalism

2.1 Introduction

Banks have been a fundamental component of society well before the seventeenth century, during which the first banks appeared in England in their current configuration. Banks were the sole significant financial entity during much of the nineteenth and twentieth centuries, prior to the development of the present financial system into a complex network of marketable assets, liabilities, hazards, claims and counterclaims. Banks are the most important component of the financial system nowadays.[25]

This chapter argues that bank customers as consumers of banking services, despite being free to negotiate and contract with their banks, need legal protection therefrom. The chapter starts with a discussion on the conflict between freedom of contract and legal intervention and protection. It discusses *inter alia* that there are three different rationales for bank customer protection, namely, market efficiency, paternalism and redistribution, which rationales confer different degrees of protection. Thereafter, the chapter explores the reasons for the requirement for legal intervention and protection. The reasons brought forward are the very reasons which have enabled banks to act dishonestly and unfairly towards customers.[26] These reasons are customers' behavioural biases, weaker position

[25] Ross Cranston and others, *Principles of Banking Law* (3rd edn, Oxford University Press 2017) 4.
[26] Ruth Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' in Costanza Russo, Rosa Lastra and William Blair (eds), *Research Handbook on Law and Ethics in Banking and Finance* (Edward Elgar Publishing 2019) 214.

and vulnerability, the essentiality of banking services, risk of financial exclusion, and the risk of banks' misconduct. The chapter contends that the law needs to be sufficiently interventionist to adequately protect bank customer financial welfare and advocates a particular type of impure paternalism with a restricted degree of wealth redistribution.

2.2 Freedom of contract against paternalism

It is well known that English law prioritises the core concepts of freedom of contract and autonomy of the parties.[27] Indeed, English courts have confirmed the relevance of such concepts in various judgments.[28] In *Prime Sight Ltd v Lavarello*, the court affirmed that '[p]arties are ordinarily free to contract on whatever terms they choose and the court's role is to enforce them'.[29] Thus, bank customers can freely negotiate financial products and services with banks under contract law.[30] It has also been argued that parties should ordinarily be bound by their contracts, irrespective of how excellent or horrible they are,[31] and that the principle of *pacta sunt servanda* should be observed.[32] Courts should not merely sympathise with a party in an unfavourable position, affect a lawsuit's outcome and deny the other party of the benefits of a good agreement.[33] It has been claimed that the concepts of contract freedom and contracts' binding strength forbid limits on contract terms' effectiveness once a contract is signed.[34] Excluding such doctrines as undue influence and the penalty rule, generally, any limits' acknowledgment has been refused

[27] *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827.
[28] eg *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172; *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619; *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch).
[29] *Prime Sight Ltd v Lavarello* [2013] UKPC 22, [2014] AC 436 [47].
[30] Norbert Horn, 'The Bank/customer Relationship in German and European Law' (1995) 10(3) Journal of International Banking and Financial Law 116.
[31] Paul S Davies, 'Bad Bargains' (2019) 72(1) Current Legal Problems 253.
[32] Reinhard Zimmermann, 'Consumer Contract Law and General Contract Law: The German Experience' (2005) 58(1) Current Legal Problems 415.
[33] *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172 [168].
[34] *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827, 844.

or restricted at common law.[35] The relevance of legal certainty, party autonomy and contract freedom has been emphasised.[36]

Furthermore, it has been noted that a banking contract may delegate discretion to the bank to unilaterally change the contract terms.[37] It has been argued that in the commercial sphere, the exercise of such contractual discretion should not be interfered with as it is founded on contract freedom and sanctity, and also in the interests of commercial certainty.[38] It has been submitted that a party may be willing to enter into a disproportionate contract, wherein contractual discretion is placed in the other party and appears to provide them with little or no advantage, and risks opportunism by the other party, for a variety of reasons. For instance, discretion may be the solution to future upheaval; the other party requires discretion to protect their financial interest and reputation; the party may consider it a risk worth taking to obtain a superior bargain;[39] or to have the deal executed.[40]

However, it is argued that party autonomy signifies that contractual discretion must nevertheless manifest both parties' aim.[41] It is unlikely that limitless contractual discretion manifests both banks and customers' intention because it is unlikely that customers intend for contractual discretion to be exercised unrestrictedly.[42] As the court noticed in *Paragon Finance v Nash*, 'a contract where one party truly found himself subject to the

[35] Simon Whittaker, 'Unfair Terms in Commercial Contracts and the Two Laws of Competition: French Law and English Law Contrasted' (2019) 39(2) Oxford Journal of Legal Studies 404; *Cavendish Square Holding BV v Makdessi* [2015] UKSC 67, [2016] AC 1172; *Arnold v Britton* [2015] UKSC 36, [2015] AC 1619; *Canary Wharf (BP4) T1 Ltd v European Medicines Agency* [2019] EWHC 335 (Ch).
[36] Davies (n 31).
[37] Richard Hooley, 'Controlling Contractual Discretion' (2013) 72(1) The Cambridge Law Journal 65.
[38] Jonathan Morgan, 'Against Judicial Review of Discretionary Contractual Powers' (2008] Lloyd's Maritime and Commercial Law Quarterly 230.
[39] Hugh Collins, 'Discretionary Powers in Contracts' in David Campbell, Hugh Collins and John Wightman (eds), *Implicit Dimensions of Contracts: Discrete, Relational and Network Contracts* (Hart Publishing 2003) 219, 226–231.
[40] Hooley (n 37).
[41] Terence Daintith, 'Contractual Discretion and Administrative Discretion: A Unified Analysis' (2005) 68(4) Modern Law Review 554.
[42] Hooley (n 37).

whim of the other would be a commercial and practical absurdity'.[43] It is further contended that despite banks may not employ contractual discretion dishonestly or irrationally for fear of reputational damage, they cannot be trusted and left to be controlled by the market because such control is unreliable or non-existent.[44] Moreover, allowing unrestricted discretion in a long-term contract which relies on the parties' collaboration, may jeopardise the contract's financial potential.[45]

It is claimed that to discern whether legal protection is necessary, it is fundamental to identify the right balance between the parties' liberty to contractually safeguard their rights and the law's interests to ascertain that such liberty is employed properly. Whilst some value judgment is involved to determine what is and what is not appropriate, it is suggested that this is probably the optimal strategy to pursue in a field dominated by commercial pragmatism and realities.[46] The mere fact that banks act in a professional capacity whereas customers do not, creates a disparity between them. Yet, such an imbalance is not one that requires legal protection. The core factor justifying legal intervention is the restriction of customers' capability to decide freely and rationally. Obviously, this restriction exists only in particular circumstances, namely, where they are in danger of signing contracts that reflect banks' interests rather than those of both parties. Such circumstances must be identified for the law to be able to protect customers' right to self-determination. In this sense, contract freedom should be viewed as a tool for achieving true self-determination.[47]

Further, legal protection is crucial for markets, founded on contract freedom, to operate smoothly. It has been argued that legal protection is justified when it is manifestly necessary to rectify the harm done to parties' rights to self-determination and that it must pursue a categorical approach. Given legal certainty, typically, the law must set examples.

[43] *Paragon Finance v Nash* [2001] EWCA Civ 1466, [2002] 1 WLR 685 [26] (Dyson LJ).
[44] Hooley (n 37).
[45] Collins (n 39) 231.
[46] Man Yip and Yihan Goh, 'Convergence between Australian common law and English common law: The rule against penalties in the age of freedom of contract' (2017) 46(1) Common Law World Review 61.
[47] Zimmermann (n 32).

It has been claimed that it cannot interfere in every instance where self-determination has been restricted or where such restriction is forthcoming. It has also been argued that the law should avoid using indeterminable criteria, such as vulnerability, and disputing contracts simply because they contain terms that excessively undermine one party's interests. It has been claimed that the essential question is whether, for whatever reason, such party was unable to modify the contract's content in a way that the law would deem it to fairly represent both parties' interests.[48]

It is argued that the requirement for legal intervention may be discerned from competing ethical values which underlie contract law.[49] In this regard, two different contract law approaches have been suggested. One approach explains legal intervention through the 'freedom of contract' against 'fairness' ethical values.[50] The other justifies legal intervention through the 'self-interest/reliance' and 'need' ethics. 'Freedom of contract' and 'self-interest/reliance' values base the parties' rights and duties on the contract between the parties. 'Fairness' and 'need' values base such rights and duties on a balance between the parties' interests. It may be argued that legal intervention is unnecessary because parties are 'free' to pursue their own interests and carry out self-reliant options. However, it is argued that legal protection is 'needed' to attain a 'fair' balance in the parties' interests, to safeguard the weaker party – the bank customer.[51]

In this context, it has been argued that the self-interest/reliance against need approach is more insightful than the freedom against fairness approach to conceptualise the necessity for legal protection because it is more distinct and exact in terms of conflicting values and options on levels of protection. The self-interest/reliance concept is more definitive than the 'freedom' one as it focuses particularly on the bank's freedom to seek self-interest and the customer's freedom to employ self-reliance instead of merely alluding to freedom

[48] ibid.
[49] Chris Willett, 'Re-Theorising Consumer Law' (2018) 77(1) The Cambridge Law Journal 179.
[50] Patrick S Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford University Press 1985); Chris Willett, *Fairness in Consumer Contracts: The Case of Unfair Terms* (Ashgate Publishing Limited 2007).
[51] Willett, 'Re-Theorising Consumer Law' (n 49).

or autonomy. Moreover, the self-interest/reliance notion establishes a clear distinction between conflicting ethical values. Practically, it is not possible for self-interest/reliance ethic to be mistaken with the need ethic. However, 'freedom' is occasionally used interchangeably with the need ethic.[52] In this regard, it is argued that lack of information and bargaining power hinders a party from being truly free. Hence, legal protection is required when it is necessary to ensure outcome-based consumer protection norms, that is, to enforce the norms that they would select were they truly free.[53]

This relates to an underlying philosophical debate on the meaning of freedom, or liberty. Hayek, a liberal individualist, described freedom as the absence of external coercion inflicted on an individual's will by another individual. Hence, pressure originating from physical situations limits the individual's power rather than their freedom. According to Hayek, coercion occurs when an individual's acts carry out another individual's will instead of their own.[54] While the coerced can decide, the coercer determines the coerced party's options. Therefore, ultimately, the coerced selects what the coercer wants. The former is prohibited from utilising their capacities for their own objectives and not from not utilising them at all. For an individual to be able to effectively utilise their knowledge and intelligence to pursue their objectives, they must be able to foresee their environment's conditions and comply with an action plan. Coercion is wrong because it hinders the coerced from wholly using their intellectual skills. Although the coerced will perform the best they can for themselves at any specific time, their acts comply solely with the coercer's plan.[55]

Hayek's liberal individualism is based on conventional market exchange relations and is often linked to classic laissez faire concepts, for instance, contractual freedom and exchange reciprocity. According to Hayek, an individual's impairment is a fundamental

[52] ibid.
[53] Cass R Sunstein and Richard H Thaler, 'Libertarian Paternalism Is Not an Oxymoron" (2003) 70(4) The University of Chicago Law Review 1159.
[54] Friedrich A von Hayek, *The Constitution of Liberty: The Definitive Edition*, vol 17 (Ronald Hamowy ed, University of Chicago Press 2011) 199.
[55] Ibid 200-201.

characteristic of a liberal-individualistic institutional foundation where existing allocations of valuable assets and riches are determined by the 'free', or disorganised and uncontrolled, interplay of market forces stemming solely from competition and rational contractual choice.[56] However, it is arguable that, whilst this rationale is reasonable and appealing, it is intrinsically incapable or reluctant to recognise banks' unique inherent authority framework and their consequent extra-contractual discretionary power.[57] Therefore, it is argued that customers who contract with banks out of necessity, or financial need, are not truly free.

Additionally, it has been argued that the need ethical value relates to the social construct of 'need rationality'[58] and, like the 'fairness' concept, balances parties' interests in that both ethical values consider the weaker party's protection a 'fair' method to balance such interests. It has been further claimed that, however, the need ethical value is more accurate and appropriate than the fairness one because it prioritises the consumer's needs, namely, it protects them from their vulnerability's repercussions. Contrastingly, the vaguer 'fairness' notion does not satisfactorily demonstrate that it prioritises the weaker consumer's protection and, hence, permits the argument that prioritising the bank's self-interest and consumer's self-reliance is 'fair'. However, it is argued that customers frequently cannot exert significant self-reliance[59] for various reasons, which are discussed in the next section.

In this regard, it has been argued that consumers should be accountable for their judgments and choices in their money's management[60] and the law should not protect against all possibility of loss or the commission of errors. Finance inevitably involves risk. Hence, protecting consumers against all risk runs against the precise role of financial

[56] Ibid 201.
[57] Marc T Moore, 'Reconstituting Labour Market Freedom: Corporate Governance and Collective Worker Counterbalance' (2014) 43(4) Industrial Law Journal 398.
[58] Thomas Wilhelmsson, *Critical Studies in Private Law* (Springer 1992).
[59] Willett, 'Re-Theorising Consumer Law' (n 49).
[60] Great Britain Department of Trade and Industry, *Financial Services in the UK: a new framework for investor protection* (Cmd 9432, 1985).

contracts and finance. However, it is arguable that this does not imply that consumers do not require protection but that it is necessary to decipher what elements consumers need to be protected against and that consumers are made aware of the extent of legal protection.[61]

Indeed, it is argued that consumers should be held responsible for their decisions only where no real-world constraints exist which restrict their capacity to do so.[62] Certain important social norms,[63] especially, lack of bargaining power and contract incorrectness, take precedence over consumers' autonomy.[64] Therefore, in circumstances where such norms exist, legal intervention is necessary to assist in the retention of their autonomy and adherence to social responsibility needs. Legal protection must not be dismissed out of hand as an unjustified restriction on the parties' ability to contract freely. Instead, it should be considered a legitimate and reasonable attempt to maintain autonomy by establishing processes aimed to prevent contracts, which are not the outcome of both contracting parties' acts of self-determination, from being created or enforced.[65] Hence, legal intervention is crucial to provide *ex ante* protection, at point of purchase, or sale, of products.

Further, legal protection is essential when consumers purchase credence goods, such as financial products and services. This is because such goods are not bought for immediate consumption and the ramifications for consumers are severe if the relevant contract or seller fails. This is the more so with banks and their customers. Since banking contracts are typically long term, bank customers must be certain that, after committing themselves

[61] David T Llewellyn, 'Consumer Protection in Retail Investment Services: Protection against what?' (1995) 3(1) Journal of Financial Regulation & Compliance 43.
[62] UK Financial Conduct Authority, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (February 2021) para 1.4 <www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf> accessed 19 June 2022.
[63] Sarah Worthington, 'Common Law Values: The Role of Party Autonomy in Private Law' in Andrew Robertson and Michael Tilbury (eds), *The Common Law of Obligations: Divergence and Unity* (Hart Publishing 2016) 301.
[64] Yip and Goh (n 46).
[65] Zimmermann (n 32).

to a specific bank, the bank will continue operating, be always capable of meeting its contingent liabilities and not engage in irresponsible conduct.[66] Moreover, it is possible that the circumstances of bank customers, as consumers of banking services, change due to life events and need their contract terms to be revised accordingly. Legal intervention is necessary to monitor banks and assist bank customers in such situations and provide ex post protection, beyond point of purchase, or sale, and during the contract's duration.[67] In other words, it is fundamental that legal protection is available to ensure bank customer welfare throughout the entire bank-customer relationship. Thus, legal intervention is key to ensure both *ex ante* and *ex post* protection.

Having argued for the need for legal intervention and protection, it is critical to determine the kind of rationale for legal protection which bank customers require. In this regard, primarily, there are three possible rationales for legal protection: market efficiency, paternalism and redistribution.

2.2.1 Market efficiency

It may be argued that the ultimate rationale for legal protection is market efficiency, whereby bank customers are provided with adequate information to be able to make informed decisions. Such protection would mitigate against market flaws or failure, which would jeopardise customers' welfare in a completely unprotected economy. It may be further argued that protection should be aimed at adjusting for such market flaws and failure that cause sub-optimal results and disrupt customers' options, and not at replacing market forces and competitive pressure. Competition yields sub-optimal results when there is insufficient knowledge to take informed decisions. It may be contended that as

[66] Llewellyn (n 61).
[67] Iris H-Y Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (2021) 41(4) Legal Studies 657; Iris H-Y Chiu, Andreas Kokkinis and Andrea Miglionico, 'Addressing the challenges of post pandemic debt management in the consumer and SME sectors: a proposal for the roles of UK financial regulators' (2 October 2021) Journal of Banking Regulation <https://doi.org/10.1057/s41261-021-00180-2> accessed 18 February 2022.

long as legal protection is correctly structured, that is, it merely furnishes what is required to rectify acknowledged market defects and failures, it enhances rather than hinders market systems' effectiveness and competition, and assists to maximise customers' welfare.[68]

Notably, this type of rationale for legal protection focuses on the following forms of market flaws,[69] which essentially concern customers' informational deficit in relation to banks:[70] information asymmetry; incorrect information; difficulty in determining quality at the time the banking service is purchased; customers' assumption that the regulator has scrutinised banks' integrity and viability; possible principal-agent difficulties and conflict of interests issues; costs;[71] and complicated and obscure transactions, which may entail the use of new technologies and associated risks.[72] Hence, it may be contended that legal protection should lure customers the advantages of economies of scale generated by collaborative surveillance carried out by the regulator and furnish a guarantee of minimal basic requirements. Thus, it may be claimed that legal protection should impose the provision of the necessary information to customers to be efficient in markets[73] and be able to perform free and accountable choices.[74]

It has been contended that the imposition of such obligations is the lightest kind of legal intervention.[75] The market has recognised the significance of informed choice and the resulting decrease in protection expenses. It has been argued that the concept of a customer with a choice-based mind-set places less importance on paternalistic protection and more on disclosure, market-based remedies and competition, as well as a better appreciation of protection expenses. It also aligns with the customer's image of a risk-

[68] Llewellyn (n 61).
[69] ibid.
[70] Zimmermann (n 32).
[71] Llewellyn (n 61).
[72] Zimmermann (n 32).
[73] Llewellyn (n 61).
[74] Zimmermann (n 32).
[75] ibid, Iris H-Y Chiu, 'Book Reviews: Principles of Financial Regulation' (2017) 80(6) Modern Law Review 1193.

taker and money provider. Hence, it has been asserted that the fact that informed options are valuable for the establishment of efficient markets is unquestionable, at least in limiting legal intervention and associated expenses. Additionally, informed options induce innovation and manufacture of cost-effective products and services.[76] It has been further contended that the provision of information obligations do not conflict with the concept of *pacta sunt servanda*; rather they aim to ascertain that both contracting parties' decisions are based on strong ground. Thus, such obligations could be viewed as bolstering *pacta sunt servanda* compliance.[77]

It is submitted that the mandatory provision of information is, in principle, an excellent idea[78] and remains fundamental.[79] It is argued, however, that it is likely that bank customers just do not bother to read long typical business paperwork when they are provided with them. More significantly, the volume of mandatory information furnished to a customer does not necessarily equate to superlative transparency because a customer confronted with too much information may be just as incapable of taking an informed decision as one with no information whatsoever.[80] Additionally, notwithstanding enhanced disclosure methods and presentations, customers may still not satisfactorily understand the information provided, especially when it comes to contractual and financial provisions.[81] Therefore, imposing informative requirements on banks does not necessarily address customers' informational gap.[82]

It is further argued that, in eliminating the aforementioned problems, the market efficiency rationale would suffice only if all that is required for the assurance of bank customer welfare is the provision of adequate information for the possibility of making informed

[76] Niamh Moloney, 'Building a Retail Investment Culture through Law: The 2004 Markets in Financial Instruments Directive' (2005) 6(3) European Business Organization Law Review 341.
[77] Zimmermann (n 32).
[78] ibid.
[79] Chiu, 'Book Reviews: Principles of Financial Regulation' (n 75).
[80] Zimmermann (n 32).
[81] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 67).
[82] Zimmermann (n 32).

decisions. However, there are other factors involved besides asymmetric information which necessitate a stronger kind of legal protection than mere market efficiency. These factors, which are discussed in the next section, are not taken into account in market efficiency. The mere imposition of duties to provide information is insufficient to compensate for these factors.[83]

Moreover, banking contracts are credence goods and, consequently, consumption is not instantaneous; it does not occur at point of purchase, or sale, only, but is long term. Hence, bank customers may need assistance beyond such point and during the contract's duration. For instance, they may require their banking contracts to be adjusted post-sale for one reason or another, possibly due to a life-changing event.[84] Yet, market efficiency does not provide protection beyond point of sale. Therefore, it does not assist bank customers should they need their banking contracts to be reviewed thereafter. Thus, market efficiency does not cater for bank customer welfare beyond point of sale, that is, it fails to provide *ex post* protection during a banking contract's duration.

2.2.2 Paternalism

Paternalism is typically thought of as an external interference with an individual's will to constrain or guide that will to choose what is good for that individual.[85] A form of paternalism, specifically, libertarian paternalism, has been recognised. Such paternalism concerns the configuration of option settings for customers and the design of legislative intervention to lead customers to take good decisions.[86] It is claimed that this type of paternalism is similar to market efficiency and is, therefore, deficient because it supports

[83] ibid.
[84] Chiu, Kokkinis and Miglionico (n 67).
[85] Jason Hanna, 'Hard and soft paternalism' in Kalle Grill and Jason Hanna (eds), *The Routledge Handbook of the Philosophy of Paternalism* (Routledge 2018) ch 2; Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 67).
[86] Richard H Thaler and Cass R Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (Yale University Press 2008) 5; Cass R Sunstein and Richard H Thaler 'Libertarian Paternalism Is Not an Oxymoron' (2003) 70(4) University of Chicago Law Review 1159.

markets.[87] While it helps customers to make sense of their decisions, it is built on a market-based operational framework. It treats market products as unquestionably the point of departure for customers' welfare demands. In fact, it has been argued that robust libertarian paternalism,[88] for instance, automated enlistment or construction of option combinations to pinpoint exact options, is solely viable in the case of unequivocal standard products.[89] Libertarian paternalistic techniques, which function on the largest common element, may thus be used only infrequently.[90]

Contrastingly, another form of paternalism, namely, impure paternalism, has been proposed to bolster protection. It has been claimed that such paternalism would enhance sharing of responsibilities and duties, and would impose restraints and duties on some to safeguard others.[91] It has been argued that this kind of protection would entail legal intervention for the provision of essential services to customers, who have basic standard requirements, while regulating the industry. It has been argued that this kind of protection would not be restricted or *ad hoc* but instead would encompass a holistic framework, taking account of the whole duration of the customer's relationship with the service provider. Thus, it would provide pre-sale and post-sale assistance and care to the customer and involve the industry in a longer-term extension of customer service. It would lay down the groundwork for some to assume responsibility to assist others in taking better decisions and consider the latter's post-sale circumstances and, hence, their welfare outcomes.[92]

[87] Cass R Sunstein, 'Boundedly rational borrowing' (2006) 73(1) University of Chicago Law Review 249.
[88] Muireann Quigley 'Libertarian Paternalism, Nudging and Public Policy' in Kalle Grill and Jason Hanna (eds), *The Routledge Handbook of the Philosophy of Paternalism* (Routledge 2018).
[89] Sumit Agarwal and others, 'The Age of Reason: Financial Decisions over the Life Cycle and Implications for Regulation' (2009) Brookings Papers on Economic Activity 51 <www.brookings.edu/wp-content/uploads/2016/07/2009b_bpea_agarwal.pdf> accessed 19 June 2022.
[90] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 67).
[91] Gerald Dworkin 'Paternalism' (1972) pt III <http://web.uncg.edu/dcl/courses/vicecrime/m2/Dworkin_Paternalism.html> accessed 19 June 2022.
[92] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 67).

Thus, it is argued that impure paternalism would provide better and stronger protection than market efficiency as it is consistent with banking services being a credence good and it would take cognisance of pre-sale and post-sale stages of banking contracts. Consequently, it would monitor bank customer welfare and assist customers in achieving good outcomes throughout their whole relationship with banks. Indeed, it would provide both *ex ante* and *ex post* protection. However, it is further argued that the kind of legal protection, or paternalism, which bank customers require should also consider other important factors, which are discussed in the next section, and which are not considered by market efficiency.

2.2.3 Redistribution

It may be questioned whether legal intervention and protection are necessary in a way which requires banks to put customers' interests before their own business interests instead of reaching a good compromise,[93] in the name of social justice or financial inclusion.[94] Thus, banks' business freedom would be constrained so that wealth would be redistributed directly to customers. It may be further argued that, if pushed to its rational end, it would oblige banks to ignore any profit consideration and concentrate on the best outcome for customers,[95] thereby providing banking services even at a loss.[96] This may cause banks to become insolvent or prevent them from earning any profits whatsoever.[97]

[93] Roger Tym and Elizabeth Greaves, 'The new MCOB "best interests" rule for residential mortgages: is it fair?' (2015) 30(3) Journal of International Banking and Financial Law 160.
[94] Financial Services Authority (FSA), 'In or out? Financial exclusion: a literature and research review' (July 2000) <www.bristol.ac.uk/media-library/sites/geography/migrated/documents/pfrc0002.pdf> accessed 19 June 2022; Peter Cartwright, 'Financial Exclusion and the Consumer' (2005) 7(2) Contemporary Issues in Law 157.
[95] Tym and Greaves (n 93).
[96] FSA (n 94); Cartwright (n 94).
[97] Tym and Greaves (n 93).

It is arguable that such kind of legal protection is ludicrous. While banks should treat their customers fairly and consider their needs both *ex ante* and *ex post*, it is in the general bank customers' interests for banks to be capable of offering high quality services and products and be commercially viable.[98] Further, while banks should aid in bank customer welfare, if the law intervenes in *ex post* losses and redistributes products and services' effectiveness, this can be analogous to compelling banks to always ensure good outcomes for customers. This is incompatible with a financial system wherein customers face capital risks. Moreover, banks may be discouraged from innovating products and services which bear a higher risk and a potential for a better outcome.[99]

Thus, it is argued that the controversy is likely to centre on whether the justification for mandatory legal intervention and protection is market efficiency, providing assurance of minimum standards and increasing the overall net output of finance which benefits both banks and customers, and, ultimately, the economy as a whole, or paternalism, encompassing market efficiency as well as providing the benefits of economies of scale and enhancing customers' welfare in a way that they cannot achieve if left free.[100] It is further argued that the kind of legal intervention which bank customers require should also consider and cater for their behavioural biases, weaker bargaining position and vulnerability, banking services' essentiality and risk of financial exclusion, and banks' misconduct. These factors, or issues, are discussed hereunder.

2.3 Bank customers' behavioural biases

Bank customers, as individuals, are presumed to be rational decision makers, self-interested and able to absorb complex information.[101] Theoretically, they will be able to

[98] ibid.
[99] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 67).
[100] Llewellyn (n 61).
[101] Paul Ali, Ian Ramsay and Cate Read, 'Behavioural Law and Economics: Regulatory Reform of Consumer Credit and Consumer Financial Services' (2014) 43(4) Common Law World Review 298.

make the best choice available if served with accurate and adequate information before a contract is concluded. Yet, a comprehensive body of behavioural research challenges this notion. An individual who is significantly less rational, emotional and influenced by personal beliefs and concerns, dislodges the notion of the 'utility-maximising *homo economicus*', who is completely aware, free from cognitive restrictions and capable of selecting the best option for them.[102]

Behavioural economics, based on human psychology, demonstrates that individuals are not only not as rational or selfish or self-controlled as assumed but also that when they are irrational, selfless and incontinent, they behave in a systematically predictable manner, termed behavioural biases.[103] Individuals are subjected to cognitive and behavioural biases in decision-making, especially when decisions necessitate voluminous and complex information to be absorbed.[104] As a result, individuals may make decisions which lead to suboptimal outcomes and are at odds with traditional financial theory.[105] According to empirical analysis, individuals can commit noticeable cognitive errors when deciding.[106] Behavioural economics demonstrate that individuals are boundedly rational, boundedly will-powered and boundedly self-interested.[107] Human cognitive capabilities are limited. In this regard, it has been claimed that the amount of mandatory information delivered to consumers does not necessarily result in commendable transparency. Consumers who are bombarded with information are just as likely to make poor decisions as those who have not received any information whatsoever.[108]

[102] Yeşim M Atamer, 'Why Judicial Control of Price Terms in Consumer Contracts Might Not Always Be the Right Answer – Insights from Behavioural Law and Economics' (2017) 80(4) Modern Law Review 624.
[103] Ali, Ramsay and Read (n 101).
[104] Thaler and Sunstein (n 86) 97.
[105] Ali, Ramsay and Read (n 101).
[106] Chris Field and Tracey Atkins, 'Behavioural Economics and Consumer Policy' (2012) 40(1) *Australian Business Law Review* 382.
[107] Christine Jolls, Cass R Sunstein and Richard Thaler, 'A Behavioral Approach to Law and Economics' (1998) 50 Stanford Law Review 1471.
[108] Zimmermann (n 32).

In fact, individuals frequently utilise heuristics to handle information overload. This may be considered as a rational option to a certain degree since thinking time would be tremendously reduced. However, heuristics frequently lead to actions which deviate from normal economic forecasts. Additionally, individuals have a tendency to act in ways which are detrimental to their long-term objectives. Given that they suffer from self-discipline issues, they do so notwithstanding that they are aware of their limitations.[109] Moreover, the manner choices are presented can either expedite or hinder decisions. For instance, when the information is complex and perplexing, individuals are more likely to employ handling methodologies to decide. According to Thaler and Sunstein, this is when individuals are likely to get into mischief.[110] Thus, it is argued that this is even more likely with banking services and contracts. Given their complexity and boredom, the emotions involved and the hard probability judgments, bank customers are distinctly liable to making instinctive mistakes akin to behavioural biases.[111]

Further, it has been claimed that, in contrast to the notion of *homo economicus*, consumers believe in fairness and are not only motivated by strictly focused self-interest. According to behavioural economics, the systematic biases in consumers' future expectations explain their faulty reasoning. It has been argued that there are five main biases. The first is excessive optimism and overconfidence.[112] Consumers are unduly enthusiastic on their future earnings. They frequently underestimate the likelihood of becoming jobless, being involved in an accident, becoming ill, or divorcing, all of which can result in financial difficulties. Consumers also consistently decline to foresee their future decisions and, consequent to their overconfidence, misinterpret price vector components.[113] The second bias is short-sightedness and self-discipline difficulties. Some consumers are short-sighted, prioritising the transaction's immediate advantages

[109] Atamer (n 102).
[110] Thaler and Sunstein (n 86) 96.
[111] Caroline Hobson, 'Behavioural economics: a new basis for FCA intervention' (2014) 3(5) Compliance & Risk Journal 6.
[112] James A Shepperd, Erika Waters, Neil D Weinstein and William MP Klein, 'A Primer on Unrealistic Optimism' (2015) 24(3) Current Directions in Psychological Science 232; Sunstein (n 87) 267.
[113] Michael D Grubb, 'Failing to Choose the Best Price: Theory, Evidence, and Policy' (2015) 47(3) Review of Industrial Organization 303, 310.

over its long-term disadvantages. For instance, since consumers concentrate on introductory small premiums and put less emphasis on large future premiums, they choose a mortgage loan contract comprising increasing instalments.[114] The teaser rate, that is, the small initial interest rate, is a commercial modelling approach which appeals to consumers' flawed reasoning. Furthermore, consumers misjudge their future borrowing proclivity and lack current self-discipline.[115]

The third bias is compounding expense disregard. Bounded rationality is generally the result of ignoring the compounding impact of numerous comparatively little lending decisions that leads to credit card difficulties.[116] The fourth bias is complexity neglect. Many times, insufficiently reasonable consumers ignore complexity. For instance, they make their judgments easier by ignoring seemingly trivial pricing components and using alernative simpler psychological routes which frequently misead them.[117] Consumers find it difficult to choose the correct price when prices are complicated.[118] Consequently, they are more likely to sign contracts that do not suit their best interests.[119] The fifth bias is the investment effect and status quo bias. The investment effect is that consumers value items more since they believe they are entitled thereto.[120] Consumers are risk averse, hence, they prefer the current situation rather than changes in the hope of avoiding losses.[121] Moreover, adjusting the current situation involves acquiring information, contrasting it and determining the best deal available. This may be more expensive than the adjustment's added advantages. In such conditions, consumers' indifference may be

[114] Oren Bar-Gill, 'The Law, Economics and Psychology of Subprime Mortgage Contracts' (2009) 94 Cornell Law Rev 1073, 1120.
[115] Ryan Bubb and Richard H Pildes, 'How Behavioral Economics Trims Its Sails and Why' (2014) 127 Harvard Law Review 1593, 1642.
[116] Sunstein (n 87) 251.
[117] Oren Bar-Gill, *Seduction by Contract – Law, Economics, and Psychology in Consumer Markets* (Oxford University Press 2012) 18-21.
[118] Grubb (n 113) 310.
[119] Martin Engel and Johanna Stark, 'Buttons Boxes, Ticks, and Trust – On the Narrow Limits of Consumer Choice' in Klaus Mathis (ed), *European Perspectives on Behavioural Law and Economics* (Springer 2015) 107, 116.
[120] Daniel Kahneman, Jack L Knetsch and Richard H Thaler, 'Experimental Tests of the Endowment Effect and the Coase Theorem' (1990) 98(6) Journal of Political Economy 1325.
[121] Klaus Mathis and Ariel David Steffen, 'From Rational Choice to Behavioural Economics: Theoretical Foundations, Empirical Findings and Legal Implications' in Klaus Mathis (ed), *European Perspectives on Behavioural Law and Economics* (Springer 2015) 41.

reasonable.[122] The current situation bias is the main cause of switching inertia in long-term contracts. Although consumers are occasionally cognisant of the contract's disadvantages, they are hesitant to seek different alternatives due to expenses and unpredictability of outcomes.[123]

2.4 Bank customers' weaker position

It is arguable that bank customers need legal protection due to their weaker position relative to banks. The significant power disparity between banks and customers is a major characteristic of customers. Substantial differences exist in professional knowledge, financial activities' management and oversight, and the parties' financial and bargaining strength. Customers are also in a weaker situation than banks given information asymmetries and their dependence on banks. Customers' weaker position is present throughout all the stages of their relationship with banks, from negotiation to banking contract signature, contract execution and relationship termination.[124]

2.4.1 Weaker bargaining position

Bank customers will strive to succeed in bargaining with banks notwithstanding that they are conscious that they must negotiate to obtain the best results. Single customers are rarely sufficiently valuable to be able to bargain strongly with banks. Thus, their weaker situation renders any negotiations to remove any harsh or unfair provisions fruitless. Furthermore, customers lack banks' knowledge and expertise in bargaining as they do not negotiate regularly.[125] Additonally, if banks experience financial loss, for instance,

[122] Michael G Faure and Hanneke A Luth, 'Behavioural Economics in Unfair Contract Terms – Cautions and Considerations' (2011) 34(3) Journal of Consumer Policy 337.
[123] Atamer (n 102) 632.
[124] Plato-Shinar (n 26); Ruth Plato-Shinar, 'The Banking Contract as a Special Contract: The Israeli Approach' (2013) 29(3) Touro Law Review 721.
[125] Roger Brownsword, *Contract Law: themes for the twenty-first century* (2nd edn Oxford University Press 2006), 79–85;

consequent to customers' breaches, or fail to achieve the expected profits, frequently, they are in a comparatively good situation to bear such loss. Contrastingly, customers are often less capable of enduring financial loss consequent to inappropriate financial products and services, or unfair and harsh provisions. Moreover, these and other issues may prejudice their personal lives, for instance, stress, hassle, waste of time and irritation of not being able to obtain compensation. Banks are not normally influenced in this manner.[126]

Absent knowledge, experience and competence, bank customers strive to defend themselves from detriment caused by inappropriate products, services or harsh or unfair terms. Bank customers frequently have a restricted grasp of the dangers associated with failure of banking services or financial products or with standard provisions. Furthermore, notwithstanding that provisions may be clear, this is limitedly useful in practice to assist bank customers safeguard their interests. Frequently, they lack the time to study the auxiliary provisions before signing a contract, instead focusing on the fundamental concerns, primarily, products, services and principal pricing. Further, despite bank customers review the basic provisions, having restricted experience, they find it hard to assess the likelihood that the instances addressed will arise.[127] For example, they may have difficulty determining when contingent fees are due.[128]

Further, banks are not under considerable stressful competition to be compelled to provide conditions which are favourable to customers, to furnish standard provisions which take cognisance of customers' interests and to ensure good outcomes for customers. Hence, in terms of the aforementioned ethical values, it is arguable that bank customers strive to be self-reliant to safeguard themselves against harm due to inappropriate banking services and financial products, and harsh and unfair terms in banking contracts. Thus, bank customers' weaker situation must be considered in terms

[126] Christopher Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (2012) 71(2) Cambridge Law Journal 412; Willett, 'Re-Theorising Consumer Law' (n 49).
[127] Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (n 126).
[128] Willett, 'Re-Theorising Consumer Law' (n 49).

of a need-based aspect. In other words, with reference to a need-based aspect, customers need legal protection from detrimental outcomes because self-reliance is unlikely to be possible in view of their limited skill, knowledge, experience and power.[129] Customers will find it hard to bargain with banks to voluntarily agree to guarantee good outcomes and to win arguments at a later stage on whether banks have acted with reasonable care and skill in their procedures, especially where technology is involved.[130]

2.4.2 Information asymmetries

A significant advantage which banks have on customers is that they have a substantial amount of information regarding the products and services they provide whereas customers are less well informed.[131] When customers lack sufficient information to take an optimal decision, they are frequently challenged with poorly-defined and ambiguous practical difficulties.[132] Information asymmetries between banks and customers are especially problematic when large transactions, for example, pension plans and home mortgages, are combined with complexity and uncertainty. These entail significant investment and borrowing decisions covering lengthy timeframes, and minor errors may add up to an enormous loss before the product reaches maturation.[133]

Bank customers are especially susceptible to cutthroat banks providing banking services and financial products, which are not of high quality as advertised or as adequate for a particular customer as other banking services and financial products available on the market, due to information asymmetries. Ordinarily, it is impossible to ascertain banking

[129] ibid.
[130] Department for Business Innovation & Skills, 'Enhancing Consumer Confidence by clarifying Consumer Law' (July 2012) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31350/12-937-enhancing-consumer-consultation-supply-of-goods-services-digital.pdf> accessed 19 June 2022.
[131] John Armour and others, *Principles of Financial Regulation* (Oxford University Press 2016) 55.
[132] John Kay and Mervyn King, *Radical Uncertainty: Decision-making for an Unknowable Future*, (The Bridge Street Press 2020) 47.
[133] Armour and others (n 131) 55.

services and financial products' quality after purchase because they are credence goods. Hence, since credible standards against which to measure accomplishment do not exist, quality must be taken on trust or faith. Customers may, therefore, experience the 'adverse selection' difficulty and suffer harm.[134]

Moreover, other problems stem from asymmetric information. Bank customers are incapable of effectively supervising banks' actions either because they generally lack the professional expertise and technical means necessary or they receive information, for instance, relating to their accounts, retrospectively. Hence, even if they hire relevant professional services, which involve large financial costs, they will not resolve the difficulty.[135] Therefore, they must trust banks' professionalism and integrity in their obligations' execution.[136]

Furthermore, bank customers as investors must trust banks with their investment decisions, trade execution and/or secure asset custody. The risks for customers inherent in the selected investments, investment decisions and custody of assets arise from the actions that banks take during the relationship, which actions are also extremely hard for customers to supervise.[137] Thus, asymmetric information generates agency costs.[138] Additionally, the more competitive the market, the more banks are likely to be induced to accentuate favourable essential features and slip unattractive ones into less conspicuous areas. Financial products may be easily modified to enhance revenue because they are merely contracts. Therefore, besides being difficult to evaluate whether any given product promotes bank customer welfare, customers risk banks deliberately designing a product to take advantage of their naivety.[139]

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[134] ibid.
[135] Robert Cooter and Bradley J Freedman, 'The Fiduciary Relationship: Its Economic Character and Legal Consequences' (1991) 66 New York University Law Review 1045, 1049.
[136] Plato-Shinar, 'The Banking Contract as a Special Contract: The Israeli Approach' (n 124).
[137] Armour and others (n 131) 63.
[138] Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) Journal of Financial Economics 305.
[139] Armour and others (n 131) 206.

Information asymmetries have consequences on financial markets too. They may compel the latter to dwindle or collapse. Markets respond by reducing problems of information asymmetries and furnish decent cues on which customers can rely. One such sign is a guarantee or warrant of the product's quality. Financial markets frequently have excessive information asymmetries and the interval bank customers' detachment from their money and its return can be lengthy. Consequently, it may be too late prior to customers understanding that the decent and reliable cues earlier furnished were meaningless. Hence, market mechanisms may be too frail to deter efforts which exploit weaker customers.[140]

2.4.3 Customers' dependence on banks

In addition to the concern with abuse of power, bank customers' weaker position is problematic when it makes them dependent on the stronger banks. This occurs in relation to the prices of banking services. Banks are typically free to determine the prices of their services without any formal restriction. Bank customers have no actual power to negotiate prices and frequently no option but to pay the fees which banks dictate. Truly, many other sectors determine the prices which customers must pay for the products or services. However, banking services' essentiality makes customers dependent on banks. Therefore, they have no option except to pay the requested fees. Such fees can be rather high and lead to unfair fee arrangements during lack of competition.[141]

Bank customers also depend on banks' discretion to determine the legal rules applicable to their relationship. Banking contracts are standard documents that banks prepare ahead of time. Despite the bank may agree to negotiate contract terms with a specific customer, the negotiations are based on the bank's original document, which clearly protects the latter's interests. Generally, the banking contract encompasses several

[140] ibid 56.
[141] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 226.

duties with which the consumer must comply. When the banking contract refers to the bank, it typically refers to the latter's rights vis-à-vis the consumer.[142]

Customers' dependence on banks is enhanced given the difficulties in switching banks.[143] Even if customers are strongly enticed to switch banks, for instance, a significant price difference in the provision of banking services, the technical difficulties connected with the move deter many customers. Moreover, even if the difficulties of the move were resolved, and customers could switch easily between banks, the move to another bank would not alter the customer's situation or their dependence on the bank much. The power inequality between the bank and customer would continue to exist even after their move to a new bank. The customer is not solely confined to one bank but to the entire banking system due to the monopolistic characteristic and the incapability of receiving banking services external to the banking system.[144]

Additionally, customers require legal protection given banks' control and discretion over their financial interests. Banks have control over customers' money once placed in the former's hands. Also, banks have discretion on the manner they carry out their obligations. For example, banks have a discretion on whether to provide a credit facility to customers who have a current account. When banks grant a credit limit to customers, they may unilaterally decide to cancel or decrease the facility. Banks that furnish loans to customers may, upon the actualisation of certain conditions, accelerate the loan repayment.[145] Banks have a discretion on whether to realise collateral which customers provide as security for their duties. Banks have a discretion on whether to assist customers who have difficulties to repay debt, for instance, through debt restructuring. The various measures which banks have at their disposition to pressure customers to ensure debt recovery, together with the internal information banks possess on customers,

[142] ibid.
[143] Office of Fair Trading, 'Review of the Personal Current Account Market 94–99' (January 2013), <http://webarchive.nationalarchives.gov.uk/20140402142426/http:/www.oft.gov.uk/shared_oft/reports/financial products/OFT1005rev> accessed 19 June 2022.
[144] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 227.
[145] FCA Handbook, MCOB 13.

enhance banks' control over their customers' financial affairs.[146]

Given their weaker position and dependence on banks, customers must rely on banks. Customers accord a peculiar trust on banks, which trust replaces actual knowledge, understanding and capability to monitor banks. Customers confide totally on banks' discretion and judgment. Customers rely so heavily on banks that they ordinarily neither fetch another opinion prior to adopting the bank's advice nor assess its action. Customers expect banks to act professionally, responsibly and with good faith. Additionally, customers conceive banks to work in the former's best interests. Being aware thereof, banks encourage customers to continue doing so. Banks need public trust to exist.[147] Undeniably, past scandals have devastated such public trust. Nonetheless, customers continue to trust banks in their daily activities.[148]

2.5 Customers' vulnerability

Another reason why bank customers need legal protection is that they are or may become vulnerable at some point in their lives, regardless of their income level, aptitude or circumstances.[149] Customers should ordinarily be accountable for their decisions and

[146] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 227-228.
[147] House of Lords, House of Commons, Changing Banking for Good: Report of the Parliamentary Commission on Banking Standards, Volume II (June 2013) 82-83, 85 <www.parliament.uk/globalassets/documents/banking-commission/Banking-final-report-vol-ii.pdf> accessed 20 June 2022.
[148] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 228.
[149] FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (December 2014) 35 <www.fca.org.uk/publication/research/vulnerability-exposed-research.pdf> accessed 21 June 2022; FCA, 'Occasional Paper No 8: Consumer Vulnerability' (February 2015) 6, 17 <www.fca.org.uk/publication/occasional-papers/occasional-paper-8.pdf> accessed 21 June 2022; FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.13.

options[150] affecting their immediate and/or future financial well-being.[151] However, customers with vulnerability characteristics may have diverse or added demands and their capability or desire to take decisions or to defend their interests may be limited. These customers may be more susceptible to harm, especially when a problem occurs.[152] Criteria, such as weaker bargaining position, behavioural biases, information asymmetries and lack of understanding, which, even absent deliberate exploitation, may hinder customers' capability to decide well, are intensified in customers with characteristics of vulnerability.[153]

Vulnerability is a vague concept for which there is no clear definition or thorough evaluation.[154] Vulnerable consumers are characterised as individuals whose financial stability is tenuous.[155] Vulnerable consumers are also defined as individuals particularly prone to harm because of personal situations, specially, where a firm fails to exercise proper care.[156] Contextual considerations which are harmful to bank customers, for instance, family problems and industry systems, should be included in a comprehensive taxonomy of vulnerability.[157]

[150] FCA, 'Finalised Guidance FG 21/1: Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 1.4.
[151] Arvid O I Hoffman and Simon J Mcnair, 'How Does Consumers' Financial Vulnerability Relate to Positive and Negative Financial Outcomes? The Mediating Role of Individual Psychological Characteristics' (2019) 53(4) The Journal of Consumer Affairs 1630.
[152] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 1.5.
[153] FCA, 'Consultation Paper CP21/36: A new Consumer duty: Feedback to CP21/13 and further consultation' (December 2021) para 2.3 <www.fca.org.uk/publication/consultation/cp21-36.pdf> accessed 21 June 2022.
[154] Hoffman and Mcnair (n 151).
[155] Consumer Financial Protection Bureau, 'Empowering low income and economically vulnerable consumers: Report on a national convening' (November 2013) <https://files.consumerfinance.gov/f/201311_cfpb_report_empowering-economically-vulnerable-consumers.pdf> accessed 21 June 2022.
[156] FCA, 'Occasional Paper No 8: Consumer vulnerability' (n 149) 7; FCA, 'FCA Mission: Approach to Consumers' (July 2018) 10 <www.fca.org.uk/publication/corporate/approach-to-consumers.pdf> accessed 21 June 2022; FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.5.
[157] Peter Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (2015) 38(2) Journal of Consumer Policy 119; Chiu, Kokkinis and Miglionico (n 67).

Vulnerability can be sporadic, temporary or permanent in nature.[158] It may be the consequence of short-lived circumstances,[159] for instance, job loss, or long-lived ones, for instance, a disability. It may be abrupt, for instance, a major disease diagnosis, or progressive, for instance, Alzheimer's disease. It may be cyclical and variable, for instance, a mental disease. Numerous customers find it difficult to interact with banks because they suffer from long-term mental or physical problems.[160] Vulnerability has different facets and is as diverse as the customers it affects. Frequently, it is not easily classifiable. Certain vulnerability instances are clearer than others. However, despite such clearer examples, the experiences of individuals who fall into every vulnerability class are usually highly varied. Moreover, in practice, different characteristics of vulnerability frequently overlap[161] and are intricately linked. Bank customers are routinely exposed to multiple risk factors, making financial difficulties, misery and stress difficult to attribute to a single cause.[162] Additionally, a vulnerability may lead to another.[163]

Personal traits, for instance, health, cognitive capability, age and social class, interact with personal situations, for instance, life-changing events, and with external circumstances, for instance, discrimination, to create consumer vulnerability, which is often perceived as a sense of helplessness and a restricted capability to interact successfully in markets.[164] In fact, the FCA has restrictively associated vulnerability with four key drivers, namely, health, that is, health issues or diseases which influence capability to carry out daily activities; life-changing occurrences, for instance, employment loss, death in the family, or broken marriage; perseverance, that is, poor capability to tolerate emotional or financial upsets; and proficiency, that is, poor financial affairs'

[158] FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 6, 17.
[159] Bertrand, Marianne, Sendhil Mullainathan and Eldar Shafir, 'Behavioral Economics and Marketing in Aid of Decision Making among the Poor' (2006) 25(1) Journal of Public Policy & Marketing 8.
[160] FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 6, 17.
[161] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.10.
[162] FCA, Occasional Paper No 8: Consumer Vulnerability' (n 149) 23.
[163] ibid; FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (n 149) 10.
[164] Stacey Menzel Baker, James W Gentry, and Terri L Rittenburg, 'Building Understanding of the Domain of Consumer Vulnerability' (2005) 25(2) Journal of Macromarketing 128.

expertise or minimal self-assurance in money management, or other poor relevant skills, for instance, digital or learning skills.[165]

Vulnerability is a relative, rather than an absolute, condition wherein customers are at risk of becoming disadvantaged[166] and exposed, and such risk is heightened through vulnerability traits.[167] Thus, vulnerability is conceived as a spectrum of risk. Indeed, vulnerable consumers have been described as 'at-risk consumers', or market players who may be injured by market practice or are incapable or reluctant to exploit market benefits due to individual or historical situations or limitations.[168] Customers are especially vulnerable in interactions with banks after having faced a difficult circumstance which causes a financial crisis.[169] It is a common occurrence that can impact anyone. Customers' sense of vulnerability in respect of their financial resources is underpinned by such conflict between difficult and routine.[170]

Thus, common risk factors of vulnerability entail financial illiteracy, poor education, physical disability, chronic diseases, mental health problems, poor income, excessive debts, care duties, age extremes, and significant life-changing events, for instance, a family member's death, broken marriage and employment loss.[171] Obviously, not all

[165] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.5.
[166] FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (n 149) 10.
[167] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.5.
[168] Cornelia Pechmann and others, 'Navigating the Central Tensions in Research on At-Risk Consumers: Challenges and Opportunities' (2011) 30 (1) Journal of Public Policy & Marketing 23.
[169] FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 6.
[170] FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (n 149) 35.
[171] Geng Cui and Pravat K Choudhury, 'Consumer Interests and the Ethical Implications of Marketing: A Contingency Framework' (2003) 37(2) Journal of Consumer Affairs 364; Merlyn A Griffiths and Tracy R Harmon, 'Aging Consumer Vulnerabilities Influencing Factors of Acquiescence to Informed Consent' (2011) 45(3) Journal of Consumer Affairs 445; George P Moschis, Jill Mosteller and Choong Kwai Fatt, 'Research Frontiers on Older Consumers' Vulnerability' (2011) 45(3) Journal of Consumer Affairs 467; Jeff Jianfeng Wang, 'Credit Counseling to Help Debtors Regain Footing' (2010) 44(1) Journal of Consumer Affairs 44; Drew M Anderson, Alexander Strand, and J Michael Collins, 'The Impact of Electronic Payments for Vulnerable Consumers: Evidence from Social Security' (2018) 52 (1) Journal of Consumer Affairs 35; James W Gentry and others, 'The Vulnerability of Those Grieving the Death of a Loved One: Implications for Public Policy' (1995) 14(1) Journal of Public Policy & Marketing 128; Carol Kaufman-Scarborough and Terry L Childers, 'Understanding Markets as Online Public Places: Insights from Consumers with Visual

customers who fit into any one or more of such classes will suffer financial harm. However, in every case there is a risk of financial hardship and its consequences.[172]

Moreover, academic research reveals that financial hardship can have harmful psychological consequences, for instance, customers' cognitive impairment,[173] and enhanced stress.[174] Stress may induce a psychological transition from purpose-directed to routine conduct.[175] Additionally, significant vulnerability risk criteria, for instance, poverty, may cause increased time deferral,[176] shifting customers' attention to immediate rather than remote concerns. Hence, given their emotional state and reduced cognitive and functional ability, consumers in difficult financial situations may suffer psychological and financial consequences. Indeed, psychological factors are important to understand better financial capability issues.[177]

It has also been suggested that consumers' psychological features, for instance, debt attitudes, are repercussions and not drivers of personal circumstances, for instance, the debt burden. Furthermore, financial restrictions are held to put focus on urgent needs and objectives,[178] influencing consumers' temporal preferences and contemplation of future implications. Hence, it has been claimed that the financial vulnerability's aforementioned risk criteria, for instance, poor income, and excessive debt, are linked to financial outcomes directly as well as indirectly, via their impact on personal psychological features, for instance, personal savings orientation and future repercussions'

Impairments' (2009) 28(1) Journal of Public Policy & Marketing 16; Jacquelyn Litt and others, 'Leaving Welfare: Independence or Continued Vulnerability?' (2000) 34(1) Journal of Consumer Affairs 82; Shannon B Rinaldo, 'Consumer Independence, Vulnerability and Public Policy: The Case of Free Matter for the Blind' (2012) 46(1) Journal of Consumer Affairs 107.

[172] Hoffman and Mcnair (n 151); FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 23.

[173] Sendhil Mullainathan and Eldar Shafir, *Scarcity: Why Having Too Little Means So Much*, (Times Books 2013)

[174] Sarah Brown, Karl Taylor and Stephen Wheatley Price, 'Debt and Distress: Evaluating the Psychological Cost of Credit' (2005) 26 (5) Journal of Economic Psychology 642; John Gathergood, 'Debt and Depression: Causal Links and Social Norm Effects' (2012) 122 (563) Economic Journal 1094.

[175] Lars Schwabe and Oliver T Wolf, 'Stress Prompts Habit Behavior in Humans' (2009) 29 (22) Journal of Neuroscience 7191.

[176] Johannes Haushofer and Ernst Fehr, 'On the Psychology of Poverty' (2014) 344 (6186) Science 862.

[177] Hoffman and Mcnair (n 151).

[178] Mullainathan and Shafir (n 173).

contemplation, which operate as facilitators.[179]

It has been claimed that consumers experience different types of vulnerability. First, in a hypothetical perfect market, reasonable and thoroughly informed consumers take regular decisions based on their interests, thereby exerting market confidence. When consumers are subjected to information asymmetries, the ones who are most susceptible are those who demand special attention. Such vulnerability is called informational vulnerability. Secondly, transactions in a hypothetical perfect market, transactions are entirely optional. However, in reality, certain consumers are especially vulnerable consequent to their larger proneness to coercion. Such type of vulnerability is known as pressure vulnerability. Thirdly, a hypothetical perfect market encompasses many participants with whom consumers may potentially interact. In reality, a few banks may be dominant. In fact, a handful of retail banks control the UK market, forming a tight oligopoly. Consequently, consumers have limited options, which may lead to supply vulnerability.[180] In this respect, scandals like the London Interbank Offered Rate (LIBOR) rigging, wherein banks precisely colluded with one another to manipulate the rate,[181] demonstrate the risk for consumers. Consumers may feel compelled to purchase products they barely afford due to a lack of options. In these circumstances, consumers may be exploited by rogue providers, especially loan sharks. Supply vulnerability is evidently linked to pressure vulnerability and impact vulnerability.[182]

Fourth, private law supports a hypothetical perfect market and permits consumers to make banks accountable for breaches. Yet, accessibility to redress may be more theoretical than actual and certain consumers may find it especially hard to achieve it.

[179] Hoffman and Mcnair (n 151).
[180] Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (n 157).
[181] Liam Vaughan and Gavin Finch, 'LIBOR scandal: the bankers who fixed the world's most important number' (18 January 2017) <www.theguardian.com/business/2017/jan/18/libor-scandal-the-bankers-who-fixed-the-worlds-most-important-number> accessed 18 January 2022; Jason Fernando, 'The LIBOR Scandal' (24 February 2021) <www.investopedia.com/terms/l/libor-scandal.asp> accessed 18 January 2022.
[182] Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (n 157).

Such vulnerability is called redress vulnerability.[183] A final vulnerability factor, which indicates the increased harm that consumers suffer as a result of poor judgments,[184] is called impact vulnerability.[185] Consumers who are in vulnerable situations may be substantially less capable of advocating for themselves and more prone to make poor financial choices and suffer detriment than the typical or average consumer.[186] Indeed, consumers with vulnerability features may be more sensitive to conduct traits, for instance, 'scarcity mindset'. This can limit capacity and cause consumers to prioritise aspects over others.[187] Consequently, vulnerable consumers are more susceptible to take wrong financial decisions, increasing financial challenges.[188] A difficulty or challenging interaction's consequence may be amplified, increasing vulnerability to unethical activities, producing a vicious circle.[189] Thus, it is arguable that bank customers may suffer from one or more of these types of vulnerability which may cause them to suffer harm.[190]

It is also arguable that vulnerability does not only involve customers' personal characteristics or situations. Banks' practices, policies and actions can also cause or exacerbate it. The efficiency with which customers engage with banks may be greatly influenced by how banks build their procedures and systems, and train their employees to listen and comprehend, and provide them with effective choices. Products and processes should be designed for real customers rather than for a mythical perfect customer. Vulnerability is a dynamic condition that necessitates banks' flexibility and tailoring of their responses. This is especially true considering that several customers in

[183] Ibid.
[184] Ramil Burden, 'Vulnerable consumer groups: quantification and analysis' (1998) Great Britain Office of Fair Trading, Research Paper 15.
[185] Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (n 157).
[186] Personal Finance Research Centre, 'Vulnerability: A Guide for Lending: telephony, face-to-face, and online' (June 2017) <www.bristol.ac.uk/media-library/sites/geography/pfrc/pfrc1703-vulnerability-guide-for-lending-(web).pdf> accessed 21 January 2022.
[187] Mullainathan and Shafir (n 173).
[188] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.20.
[189] FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 25.
[190] FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (n 149) 35.

risky circumstances are unaware of their vulnerability.[191]

It is emphasised that awareness of vulnerability's influence on customers' financial welfare requires a comprehension of its heterogeneity and complicacy.[192] The effects of vulnerability on daily lives cannot be overlooked. Vulnerability may have a huge impact on customers who are struggling to deal with challenging situations and resource constraints.[193] Vulnerability's emotional and practical, or cognitive and functional, consequences may affect the way customers engage with banks and may negatively impact their decision-making.[194]

Vulnerable customers are especially prone to different kinds of harm. Harm may be emotional, for instance, abashment, stress and anxiety; financial, for instance, caused by debt, arrears, debt spiral, over-indebtedness, poor options, inadequate purchase of financial products or banking services, mis-selling, excessive prices, scams or financial abuse, including misleading online financial promotions; trust loss in banks; detachment and exclusion from banking services and subsequent risk predisposition, for example, maintaining excess cash at the residence; diminished capability of attaining redress; and time lost in trying to resolve problems.[195]

The effect of vulnerability features may be aggravated by banks' conduct or business decisions.[196] When banks do not adapt to vulnerable customers' needs, the ultimate effect on consumer welfare may be adverse and customers may experience harm.[197] It is arguable that banking processes and services appear to be built for the mythical perfect

[191] FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 7.
[192] FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (n 149) 10.
[193] FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 7.
[194] FCA, 'Finalised Guidance FG 21/1: Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.20.
[195] ibid paras 2.21, 2.24; FCA, 'Occasional Paper No 8: Consumer Vulnerability' (n 149) 34-35.
[196] FCA, 'Finalised Guidance FG 21/1: Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.22.
[197] ibid para 2.23.

customer and aimed to simplify customer service. They are not designed to suit anyone's specific needs and, certainly, not those of vulnerable consumers, regardless of the commonality of their circumstances. This simplification may cause customer harm.[198] In this regard, it has been contended that, in certain cases, bank-related matters are the main cause of customer harm whereas, in other cases, banks' misconduct, such as mis-selling and customer exploitation, interacts with other problems and amplifies the harm. These problems are sometimes linked to the occurrence and/or effect of less obvious problems associated with product accessibility and customer service.[199]

For instance, a relevant study revealed that certain firms' operations were not built to cater for customers with vulnerable characteristics. These included failing to adjust communication for customers with accessibility requirements, failing to provide communication through diverse methods and failing to provide a way for customers to leave automated systems. Certain firms failed to provide suitable ways of authentication to fulfill vulnerable customers' demands while adopting customer authentication and mobile-based authentication. Certain customers lacked access to a mobile phone and needed an alternative method of authentication.[200]

Ultimately, it is argued that the kind of legal intervention required must take into account all the facets and consequences of vulnerability.

2.6 Essentiality of banking services and financial exclusion

Customers rely heavily on banks for the provision of banking services, the way such services are delivered, their price and the applicable legal framework. The banking

[198] FCA, 'Vulnerability exposed: The consumer experience of vulnerability in financial services' (n 149) 5, 35.
[199] ibid 36.
[200] FCA, 'Consultation Paper CP21/36: A new Consumer duty: Feedback to CP21/13 and further consultation' (n 153) para 2.2.

industry is not the only one where customers are reliant on service providers. Hence, it may be argued that this rationale is unsatisfactory to justify legal protection. However, the fact that banking services are essential to the public demarcates dependence in the banking environment.[201]

It is arguable that banking services are as vital as public services like water, telephone and fuel services, which are typically considered to be essential and protected by law. Essential services are said to comprise the following characteristics: a reasonable, viable alternative does not exist; the service meets a fundamental necessity for its customers; a minority of service providers are available; and the service involves a long-term relationship between the provider and customer, all of which features are met by banking services. It may be argued that banking services differ from public utilities because, ordinarily, the state is not expected to provide them. However, it is arguable that banking services, especially payment services operated through accounts and credit cards, can be deemed to be social entitlements just as standard public services are.[202] Banking services are vital for customers to live decently.[203]

It is argued that the kind of legal protection which customers need must consider banking services' essentiality. Nowadays, every individual or entity uses banking services in some form. Notwithstanding that an individual may not need corporate financing or complex operations, they may nevertheless require a bank guarantee, mortgage, loan, investment advice relating to little savings or to effect a payment through bank transfer or a direct debit order. Also, despite that their financial activities may be restricted to obtaining a wage or a social services allowance, they nonetheless need a bank account unless they

[201] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 225; FCA, 'Business Plan 2021/22' (July 2021) 29 <www.fca.org.uk/publication/business-plans/business-plan-2021-22.pdf> accessed 22 June 2022; FCA, 'Finalised Guidance FG 21/1: Guidance for firms on the fair treatment of vulnerable customers' (n 62) para 2.22.

[202] Thomas Wilhelmsson, 'Services of general interest and European private law' in Charles E F Rickett and Thomas G W Telfer (eds), *International Perspectives on Consumers' Access to Justice* (Cambridge University Press 2003) 149.

[203] F Domont-Naert, 'The Right to Basic Financial Services: Opening the Discussion' (2000) 8 Consumer Law Journal 63.

can obtain cash payments. Such banking services' necessity enhances customers' reliance on banks[204] and the latter's readiness to offer their services.[205] Moreover, banking services are necessary because customers are supposed to take charge of their financial welfare. Banking services are crucial to meaningful social involvement and serve as a link for accessing other services.[206]

2.6.1 Financial exclusion

Indeed, access to banking services is fundamental for customers' ability to fully participate in the financial markets[207] as well as in society.[208] Financial exclusion is typically associated with geographical location and similar physical factors.[209] The most conspicuous and investigated example has been the movement away from branch banking, fuelled partly by branch closures, as technology has induced customers to abandon conventional methods in favour of digital banking options. In the twelve months preceding February 2020, only 50 percent of customers having a day-to-day account conducted in-branch banking activity. While technology enhances efficiency, convenience and access to products and services for customers, it may also harm them. They may be excluded digitally, making participation in the financial system hard. For numerous consumers, even vulnerable ones, cash continues to be an essential payment mechanism. In February 2020, 10 percent, or 5.4 million consumers, held that they used cash considerably in their daily lives. Cash-reliant consumers may have difficulty accessing banking services, particularly receiving cash, because society is becoming

[204] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 226.
[205] Plato-Shinar, 'The Banking Contract as a Special Contract: The Israeli Approach' (n 124).
[206] FCA, Occasional Paper No 8: Consumer Vulnerability' (n 149) 6, 16.
[207] Olha O Cherednychenko, 'Fundamental Rights, European Private Law, and Financial Services' in Hans W Micklitz (ed), *Constitutionalization of European Private Law* (Oxford University Press 2014) 170, 186; FCA, 'FCA Mission: Approach to Consumers' (n 156).
[208] Hans-W Micklitz, 'The Paradox of Access to Financial Services for Consumers' (2010) 1 European Journal of Consumer Law 7.
[209] Nigel Thrift and Andrew Leyshon, 'Financial Desertification' in J Rossiter (ed), *Financial Exclusion: Can Mutality Fill the Gap?* (New Policy Institute 1997).

progressively cashless.[210] Poorer communities appear to have been disproportionately affected. Consumers' incapability to shopping may also be restricted physically, for instance, due to inaccessibility to a telephone, computer or car, or due to a physical disability.[211]

Five other forms of financial exclusion were identified.[212] The first is access exclusion wherein consumers' access to banking services is restricted as a result of a risk evaluation procedure, which banks can now quantify precisely. The second is condition exclusion, which involves attaching conditions to products that render them inappropriate for certain consumers' demands. This is a particular problem where savings products are concerned. The third is price exclusion, which occurs when consumers do not afford the financial products' costs.[213] Enhanced risk evaluation has increased the possibility to provide consumers with tailored financial products and represent risk in the requested price. Nonetheless, high-value consumers are constantly being singled out and provided greater deals than their less profitable peers. This could result in the ordinary consumers with access to less favourable products.[214]

The fourth kind of financial exclusion is marketing exclusion where targeted marketing and sales exclude certain consumers. Hence, they are unable to obtain information on banking services since banks do not consider it viable to attract such consumers.[215] Although consumers complain frequently about receiving too much information by way of marketing, it is useful in bringing information to their attention. The fifth is self-exclusion, which occurs when individuals decline to enrol for banking services as they feel they

[210] FCA, 'Financial Lives 2020 survey: the impact of coronavirus: Key findings from the FCA's Financial Lives 2020 survey and October 2020 Covid-19 panel survey' (11 February 2021) 17 <www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf> accessed 22 June 2022.
[211] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[212] E Kempson and C Whyley, 'Understanding and combating financial exclusion' (1999) 21 Insurance Trends 18.
[213] R Vaughan, 'Distributional Issues in Welfare Assessment and Consumer Affairs Policy' (Annex to Office of Fair Trading Working Paper OFT 255, *Vulnerable Consumers and Financial Services*, 1999).
[214] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[215] Thrift and Leyshon (n 209).

would be refused.[216]

Financial exclusion has various consequences. In extreme cases, exclusion may mean no choice. It is more likely, however, that it will mean limited choice, particularly, of inappropriate products. Where bank accounts are unavailable, money may be kept in a vulnerable location in the home, cash may be the only means of payment, and cheque cashers may be called on to provide payment services. There will also be difficulties where customers have access to bank accounts with limited facilities, for example those accounts that do not enable direct debits. In relation to credit, being turned down by major lenders signifies opting for high-cost credit, for instance, payday lending, from alternative lenders, thereby undeniably resulting in the poor being charged higher fees.[217]

Consumers who cannot open a basic bank account and/or have a credit card due to over-indebtedness or bankruptcy are not only denied the possibility to buy goods via the internet where it is not possible to pay in cash but also face the risk of being excluded from society. Particularly, they may lose their employment or strive in finding a job since their employer can solely deposit earnings into a bank account. Moreover, numerous households depend on credit and investment for long term planning and to protect themselves against unforeseen circumstances. Without access to such services, for instance, consumers may not be able to buy a family home or to provide for sufficient income after retirement.[218] In this regard, it has been claimed that access justice is important to ensure that the weaker consumers have a fair chance to participate in banking services. It prohibits discrimination in accessing products and services, and grants access rights,[219] thereby having both a negative and a positive aspect.[220]

[216] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[217] ibid.
[218] Cherednychenko (n 207) 186.
[219] Hans-W Micklitz, 'Social Justice and Access Justice in Private Law' (2011) European University Institute Working Papers Law, 2011/02.
[220] Cherednychenko (n 207) 186.

Further, reminiscent of the wealth redistribution rationale for the legal protection to bank customers, given banks' unique stance in society, banking's unique nature and importance, and banking services' essentiality, it is disputable whether this could justify the imposition of duties on banks to furnish certain banking services to customers which they would not, on a simple economic basis, furnish.[221] It has been suggested that imposing specific requirements on private firms that furnish such essential services is permissible.[222] It has been argued that banks have a responsibility to ascertain that all individuals may use their services.[223] Further, in some instances, absence of choice may arouse fair competition issues, which may require competition authorities to intervene. However, where absence of choice is due to a competing financial services sector's determination to provide solely lucrative products rather than due to improper competition, laborious issues on the respective obligations of the state and industry must be addressed.[224]

It has been argued that the burdening of social duties on banks is justified on the grounds of legitimate expectation and corporate social responsibility given their privileged position in society, significant economic power and trust generated in consumers.[225] It has been further claimed that banks' insistence on assurance and trust warrant the encumbrance of rigorous duties on banks to furnish fair access.[226] Moreover, legitimate expectation permits customers to presume that products and services are safe and of a certain standard, and contract terms do not bewilder customers.[227] Additionally, it has been remarked that banks can adjust for loss through price increases that would be burdened on numerous customers,[228] a characteristic of distributive justice.[229] Further, banks

[221] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[222] Wilhelmsson (n 202) 149.
[223] Peter Cartwright, *Banks, Consumers and Regulation* (Hart Publishing 2004) ch 8.
[224] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[225] Wilhelmsson (n 202) 149.
[226] Iain Ramsay, *Advertising, Culture and the Law* (Sweet and Maxwell 1996) 18.
[227] Geraint G Howells and Thomas Wilhelmsson, *EC Consumer Law* (Ashgate Publishing 1997) 320.
[228] Wilhelmsson (n 202) 157.
[229] Cartwright, 'Financial Exclusion and the Consumer' (n 94).

should be accountable for the difficulties they generate, pursuant to the concept of incorporating externalities.[230]

It has been counter argued that there is no consensus on banks' corporate social responsibility, that banks are not public services but intelligent financial entities that can solely be pulled into a strategy that matches their basic commercial inclinations.[231] It has been claimed that banks' corporate social responsibility is enhancing their profits.[232] Whilst legitimate expectation may justify the imposition of social duties on privatised utilities companies, the justification for the imposition of such duties on banks has been disputed. Banks were pressured to provide basic accounts, for which the banks argued that they would receive little economic benefit. Attempts were tried to convince banks that engaging in seemingly unprofitable business is in their long-term business interests. However, such attempts were met with hostility.[233]

It is arguable that, notwithstanding that the justification for the imposition of social duties on banks is not as robust as that for privatised utilities' firms and is debatable, it is conceivable that it is justified in social justice and financial inclusion's interests.[234] However, it is both unrealistic and undesirable to expect banks to furnish all services to all consumers. It has been suggested that consumers would need access to banking services which enable them to conduct online payments, accept online credit, effect cheques or cash deposits, utilise store cash back amenities and acquire cash from ATMs, to participate fully in the economy.[235] It is commended that certain banking services, particularly, basic bank accounts and money transmission services, are so crucial to

[230] Wilhelmsson (n 202) 157.
[231] Tim Sweeney, 'The Death of Banking' (British Bankers Association 2001) <www.bba.org.uk> accessed 18 May 2017.
[232] Milton Friedman *Capitalism and Freedom* (Chicago University Press Chicago 1962).
[233] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[234] ibid.
[235] Don Cruickshank, *Competition in UK Banking: A Report to the Chancellor of the Exchequer* (Stationery Office Books 2000) para 7.6.

consumers that it is adequate to compel banks to furnish them, irrespective of their economic decision.[236]

2.7 Banks' misconduct

It has been argued that customers' weaker position and vulnerability are not a sufficient reason for the law's intervention in their contractual relationship with banks. Legal protection is justified only where there is a genuine concern that customers' weaker position and vulnerability may be abused by banks. Such concern has realised more than once. The scandals that occurred throughout the years demonstrate the risks inherent in the inequality of power between banks and customers, and the genuine fear of the exploitation of banks' power to customers' detriment.[237] Such scandals include the sub-prime mortgage crisis in the United States (US), which commenced with the provision of house loans to customers with no or dubious repayment capability and involved a precarious securitisation procedure, and subsequently caused a worldwide recession, pushing the globe's banking industry towards failure;[238] the LIBOR rigging which involved collusion among the largest international banks;[239] and the payment protection insurance policies (PPI)'s widespread mis-selling in the UK, which illustrated asymmetric financial market relations between PPI providers and customers.[240]

These scandals illustrate clearly that banks acted unfairly, dishonestly, fraudulently and illegally towards customers. Banks practised unethical conduct with the sole aim to

[236] Cartwright, 'Financial Exclusion and the Consumer' (n 94).
[237] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 225.
[238] HistoryExtra, 'The 2008 financial crisis explained' (15 February 2021) <www.historyextra.com/period/modern/financial-crisis-crash-explained-facts-causes/> accessed 4 April 2022.
[239] Liam Vaughan and Gavin Finch, 'LIBOR Lies Revealed in Rigging of $300 Trillion Benchmark' (*Bloomberg*, 6 February 2013) <www.bloomberg.com/news/articles/2013-01-28/libor-lies-revealed-in-rigging-of-300-trillion-benchmark> accessed 4 April 2022
[240] Georgette Fernandez Laris, 'Scandal or Repetitive Misconduct: Payment Protection Insurance (PPI) and the not so Little Skin in Lending Games' (2020) 9(1) Moral Cents: The Journal of Ethics in Finance 3.

augment their profits.[241] Thus, it is argued that customers require the kind of legal protection that obliges banks to constantly act fairly, honestly and properly, and induce competition to function successfully in customers' interests.[242] It is further argued that the kind of legal protection required needs to prevent banks from misbehaving at all stages of the life cycle of financial products and services, causing poor outcomes and harm to consumers.[243] Bank customers may be sold inappropriate products and services which are unfit for their requirements, too risky and provide poor value for money. For instance, firms had to be stopped to prevent credit, retail and catalogue card debts getting chronic. Such credit cards were not the ideal option for long-term borrowing because customers were required to make minimal payments over long periods of time. Gains for credit card customers ranged from GBP 300 million to GBP 1.3 billion and savings for retail card customers in chronic debt were estimated to be from GBP 67million to GBP 179 million.[244]

Further, banks may exploit customers' behavioural biases. For example, they may not be entirely honest in the information supplied or provide information that is misleading or hard to grasp, thereby preventing customers from assessing adequately financial products and services. Consequently, customers may have difficulty making a prompt or rational selection. Thus, with respect to online sales, information may be structured in a manner which takes advantage of customers' behavioural biases and motivates customers to take credit or pay for items with credit, for instance, by assigning credit a much higher priority than other choices.[245] A high-cost credit study conducted between the first quarter of 2018 and the third quarter of 2019 indicated that 80 percent of customers were unable to correctly select the most affordable/cheapest overdraft product. Customers found it hard to comprehend and contrast overdraft rates due to a combination of different charging structures.[246] According to a 2019 mortgage industry analysis,

[241] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 26) 214.
[242] FCA, 'Consultation Paper CP21/36: A new Consumer Duty: feedback to CP21/13 and further consultation' (n 153) para 1.9.
[243] ibid para 1.13.
[244] ibid para 2.2.
[245] ibid.
[246] FCA, 'Consultation Paper CP 18/42: High-Cost Credit Review: Overdrafts consultation paper and policy statement' (December 2018) <www.fca.org.uk/publication/consultation/cp18-42.pdf> accessed 23 June 2022.

approximately 30 percent of customers could have obtained lower mortgages having the same main characteristics. In comparison to the lower mortgage, they spent an extra of £550 per year on average during the promotional period.[247]

Customers may not comprehend how to utilise their products and services, and may not obtain the assistance they require. This also prevents customers from taking informed and timely decisions and action and increases their expenses. In a survey conducted in 2020, in retail banking, 34 percent of consumers experiencing a service problem spent significant time to resolve it.[248] For instance, in 2015, Lloyds Banking Group was fined GBP 117 million as customers' complaints were found to have been dismissed without proper investigation. Consequently, customers did not attain prompt and appropriate redress payments.[249] Furthermore, banks' exorbitant exit costs or contract provisions deter customers from abandoning inadequate products or services or accessing better deals.[250] The aforementioned mortgages market study also revealed that around 150,000 customers found it difficult to switch whenever their mortgage interest rate reverted to the lender's ordinary rate after the conclusion of an inducement or fixed rate period.[251] Therefore, they had to remain in products which were more costly than alternatives.[252]

[247] FCA, 'Market Study MS16/2.3: Mortgages Market Study: Final Report' (March 2019) para 1.16 <www.fca.org.uk/publication/market-studies/ms16-2-3-final-report.pdf> accessed 23 June 2022; FCA, 'Sector Views 2020' (February 2020) 22 <www.fca.org.uk/publication/corporate/sector-views-2020.pdf> accessed 23 June 2022.

[248] FCA, 'Financial Lives 2020 survey: the impact of coronavirus: Key findings from the FCA's Financial Lives 2020 survey and October 2020 Covid-19 panel survey' (11 February 2021) 24 <www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf> accessed 23 June 2022.

[249] FCA, 'Lloyds Banking Group fined £117m for failing to handle PPI complaints fairly (5 June 2015) <www.fca.org.uk/news/press-releases/lloyds-banking-group-fined-%C2%A3117m-failing-handle-ppi-complaints-fairly> accessed 7 December 2021.

[250] FCA, 'Consultation Paper CP21/36: A new Consumer Duty: Feedback to CP21/13 and further consultation' (n 153) para 2.2.

[251] FCA, 'Market Study MS16/2.3: Mortgages Market Study – Final Report' (n 247) paras 1.35, 1.36; FCA, 'Sector Views 2020' (n 247) 22.

Further, technological advancements have questioned the adequacy of banks' safeguards in protecting customers' assets and preventing their networks' exploitation for financial crime, such as fraud. Customers are finding it more difficult to separate trustworthy and genuine suppliers from scams and high-risk investments and credit products consequent to online distribution networks, robotic advice and social media marketing, which facilitate access.[253] Rapid innovation and development have also increased accessibility of financial products and services. Data is constantly being used to produce important insights and furnish personalised remedies as the world moves toward digital services. This introduces novel dangers, for instance, cybercrime, technology failures, data misapplication and fraud.[254] In the first half of 2021, losses from unauthorised payment card, cheque and remote banking transactions surged to GBP 398.6 million, an increase of 7 percent from the previous year. There were 1.49 million recorded instances of unauthorised fraudulent transactions, an 8 percent increase from the previous year. Furthermore, authorised push payment frauds caused total losses of GBP 355.3 million, a 71 percent increase over the first half of 2020 and exceeding for the first time the sum of money lost via card fraud. The amount of cases increased by 60 percent to 106,164.[255]

Open Finance and Open Banking are transforming the manner customers handle their money. Open Finance can improve pricing fairness by allowing third-party suppliers to offer overspending customers better offers. However, certain customers, such as the elderly, may not utilise online technologies and may be prejudiced. Open Banking allows fintech companies to gain access to the network that underpins financial services, putting conventional banks under even more pressure for innovation. Data security and sharing are two issues that Open Banking raises. Furthermore, customers may face inertia and

[253] FCA, 'Sector Views 2020' (n 247) 8.
[254] ibid 4.
[255] UK Finance, '2021 Half Year Fraud Update' (2021) 2, 8 <www.ukfinance.org.uk/system/files/Half-year-fraud-update-2021-FINAL.pdf> accessed 23 June 2022.

greater loyalty penalties when they are unable or unwilling to utilise online technologies to look for and receive optimal bargains.[256]

According to a market survey on investment platforms, customers found it hard to browse around and select an appropriate platform founded on price. The charging structures were complicated with numerous diverse fees and penalties, varied terminology used among platforms to express identical expenses, and price information not necessarily easily accessible, conspicuous or explicit. Customers were unable to simply consider all fees, compute the overall cost of investing or contrast various solutions.[257] Moreover, customers found it difficult to switch platforms due to the time, complexity and cost of switching. Consequently, customers remained loyal to platforms that did not fit their demands anymore or provided bad quality for money.[258]

Customer behavioural biases are compounded by banks' strategic behaviour for maximising profits. Banks are compelled by competition to draft contracts that worsen customers' decision-making constraints.[259] Banks may exploit behavioural biases by drafting deliberately ambiguous contract provisions and encouraging customers to concentrate on the important characteristics which the banks emphasise.[260] Banks may also utilise a variety of techniques to conceal prices and exploit psychological processes and cognitive limitations in customers. Enhancing fee complexity and postponing fees are two typical methods.[261] In terms of complexity, the more complicated a contract's pricing scheme is, the harder it is for customers to grasp it and contrast market rates. Multidimensionality is a frequent way to achieve complexity. In employing this technique, even the most sensible and financially savvy customer would struggle to grasp which cost

[256] FCA, 'Sector Views 2020' (n 247) 7.
[257] FCA, 'Market Study MS17/1.3: Investment Platforms Market Study: Final Report' (March 2019) paras 6.5, 6.6 <www.fca.org.uk/publication/market-studies/ms17-1-3.pdf> accessed 23 June 2022.
[258] ibid paras 4.2, 4.4.
[259] Oren Bar-Gill, *Seduction by Contract: Law, Economics, and Psychology in Consumer Markets* (Oxford University Press 2012) 16-17.
[260] Paul Ali and Ian Ramsay, 'Behavioural Law and Economics: Regulatory Reform of Consumer Credit and Consumer Financial Services' (2014) 43(4) Common Law World Review 298.
[261] Bar-Grill (n 259) 17-23.

is activated and when among a slew of costs. Additionally, competing banks may impose the same costs using various names, complicating comparability.[262]

Price partitioning, which spreads the actual price, is another important strategy.[263] The charges become skewed and rise beyond the equilibrium price, rendering comparison impossible. This technique may be employed to take advantage of temporal irregularities. Customers value the weekly fee more than the entire cost because they believe they will utilise the service substantially. Therefore, they conceive the entire cost to be less compared to what it truly is. Price coupling is another technique to increase complexity.[264] Thus, payment protection insurance cover is frequently included with credit agreements. Customers are misled either due to inability to uncouple and evaluate costs or due to miscalculation of anticipated usage of coupled products, or services.[265]

Since customers tend to disregard complexity and concentrate on one pricing aspect, a frequent method for delaying fees is the employment of teaser rates, which entice customers with low short-term interest rates while exposing them to increased long-term rates.[266] This strategy takes advantage of customer myopia and optimism.[267] Customers are overconfident when it comes to contingent charges. They are unconcerned about them because they presume that they will not have to deal with them.[268] Customer exploitation stifles market competition by favouring salient-based over cost-based fee competitiveness.[269] According to a 2018 market study, charges on pension drawdown products were found to contain around forty-four fees. Since they were complex,

[262] Atamer (n 102).
[263] Hyeong Min Kim and Thomas Kramer, 'The Moderating Effects of Need for Cognition and Cognitive Effort on Responses to Multi-Dimensional Prices' (2006) 17(3) Marketing Letters 193; Willen H van Boom, 'Price Intransparency, Consumer Decision Making and European Consumer Law' (2011) 34(3) Journal of Consumer Policy 359.
[264] Oren Bar-Gill, 'Bundling and Consumer Misperception' (2006) 73(1) University of Chicago Law Review 33.
[265] Atamer (n 102).
[266] Ali and Ramsay (n 260).
[267] Bar-Gill, *Seduction by Contract: Law, Economics, and Psychology in Consumer Markets* (n 259) 19.
[268] Atamer (n 102).
[269] Bar-Gill, *Seduction by Contract: Law, Economics, and Psychology in Consumer Markets* (n 259) 54-55.

obfuscated and difficult to contrast, customers could not look for a better bargain. This resulted in less competing pressure on suppliers to provide better bargains, raising concerns that customers would be paying excessive charges. Non-advised customer fees ranged from 0.4 percent to 1.6 percent, depending on the provider.[270] Furthermore, Big Data and AI provide banks with more knowledge and data, which may be used inappropriately to influence price determinations. Banks' growing capability of personalising fees, such as for credit services, as well as the prospect for lower risk sharing, may result in unfair fees and the financial exclusion of certain customers from cheap services.[271]

Since customers may not readily avoid contracts, the consequences of drafting complex contracts and delaying costs are intensified. Inertia is caused by the fear of change bias. Despite customers may leave, they rarely do so. Inertia is exacerbated by skewed assumptions about recurring costs.[272] Additionally, banks deter customers from leaving by increasing switching fees,[273] for example, by inserting early termination fees. Therefore, customers' poor decisions have long-lived repercussions.[274]

2.8 Need for paternalism to protect consumer financial welfare

The above section has discussed the various factors which the law must consider in its intervention to provide adequate protection to bank customers. It is argued that market efficiency is insufficient as it only provides a certain degree of protection. While it addresses information asymmetries and aims to improve customers' capability of operating within the market by enhancing provision of information,[275] it disregards the

[270] FCA, 'MS16/1.3: Retirement Outcomes Review: Final Report' (June 2018) paras 1.17-1.19 <www.fca.org.uk/publication/market-studies/ms16-1-3.pdf> accessed 23 June 2022.
[271] FCA, 'Sector Views 2020' (n 247) 7.
[272] Atamer (n 102).
[273] Stefano DellaVigna and Ulrike Malmendier, 'Contract Design and Self-Control: Theory and Evidence' (2004) 119(2) The Quarterly Journal of Economics 353.
[274] Atamer (n 102).
[275] Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (n 157).

other factors, namely, bank customers' behavioural biases, their weaker position in terms of bargaining power and dependence on banks, their vulnerability, essentiality of banking services, risk of customers' financial exclusion, and banks' misconduct. In this regard, in fact, it has been claimed that when the law focuses on addressing market failure by addressing primarily information asymmetries the outcomes may be retrogressive.[276]

Moreover, as hinted in an earlier section, market efficiency aims to ensure the provision of adequate information to bank customers before contract conclusion. However, it does not assist customers beyond point of sale, that is, during the duration and until termination of the contract. It has been claimed that a multi-faceted response is necessary to address vulnerable consumers' interests.[277] It is argued that a multi-faceted response is indeed essential to address bank customers' interests, taking into consideration all the above discussed criteria. Therefore, it is argued that the kind of legal intervention necessary which accomplishes this is paternalism. Paternalism is much more appropriate than mere market efficiency.

It has been argued that a free market's fundamental principle is that consumers should decide for their welfare. However, it has also been ascertained that the market alone cannot solve its conduct defects.[278] It has been claimed that behavioural sciences caution that harsh paternalistic measures may readily have a rebound effect.[279] It has therefore been proposed that gentle paternalistic measures may be employed to offset consumer behavioural biases.[280] It has been further suggested that, based on the context, both harsh and gentle paternalistic interventions may be appropriate.[281] It is argued that the

[276] Tim Wilhelmsson, 'Consumer law and social justice' in Iain Ramsay (ed), *Consumer law in the Global Economy: National and International Dimensions* (Ashgate Publishing 1997) 217.
[277] Cartwright, 'Understanding and Protecting Vulnerable Financial Consumers' (n 157).
[278] Atamer (n 102).
[279] Caroline Hobson, 'Behavioural economics: a new basis for FCA intervention' (2014) 3(5) Compliance & Risk Journal 6.
[280] Atamer (n 102).
[281] Hugh Collins, 'Review of Oren Bar-Gill, Seduction by Contract: Law, Economics, and Psychology in Consumer Markets' (2014) 77(3) Modern Law Review 1030.

kind of paternalism which is being sought is that which strikes a right balance between harsh and gentle paternalism and which provides adequate bank customer protection.

Furthermore, the paternalism which is being advocated is not libertarian paternalism, which concentrates on defining customers' options,[282] but a kind of impure paternalism whereby onerous obligations are imposed on banks to adequately protect their customers. Impure paternalism obliges banks to assume responsibility for guiding customers to take optimal decisions, in their best interests.[283] It is further argued that the kind of impure paternalism which is being invoked should reflect the above discussed factors in the obligations imposed on banks. Thus, in assisting customers to take optimal decisions, the kind of impure paternalism being advocated will ensure that banks will not exploit customers' behavioural biases and their weaker position in terms of bargaining power, information asymmetries and dependence on banks. It will ensure that banks will draft their banking contracts clearly and not misleadingly, will not insert unfair terms and will not mask penalties as part of the price for the banking service. Bank customers will be able to decipher prices, and all costs and risks associated with banking services. They will also not be unduly influenced to enter into contracts.

Furthermore, banks will also be obliged to take cognisance of the fact that their services are essential and to assist customers from being financially excluded in any manner. They will also be obliged to take reasonable care and skill in the provision of their services to customers and provide suitable advice where necessary. Additionally, they will be obliged to sell appropriate or suitable banking services, in other words, to avoid mis-selling and any other form of misconduct, for instance, fraud. The type of impure paternalism being solicited will also provide adequate and effective redress mechanisms for bank customers in case of banks' breaches of their obligations and misconduct.

[282] Thaler and Sunstein, *Nudge: Improving Decisions About Health, Wealth, and Happiness* (n 86); Sunstein and Thaler 'Libertarian Paternalism Is Not an Oxymoron' (n 86).
[283] Dworkin (n 91); Chiu (n 67).

Such impure paternalism will also encompass post-sale considerations. It will oblige banks to assist and adequately advise customers after contract conclusion, that is, beyond point of sale, during the contract's duration until termination, should there be the need, for instance, in circumstances where customers have experienced life-changing events such as employment loss or bereavement. In such situations, banks will be obliged to provide reasonable and suitable solutions for customers.

It is further argued that such impure paternalism will provide adequate *ex-post* judicial review of banking contracts. It has been contended that court judgments cannot have maximum force due to certain frameworks restricting judicial review, for instance, those regarding deceptive charging strategies; prevailing enforcement difficulties; the requirement for each customer to institute proceedings individually to obtain redress; limitation periods; and litigation costs. Additionally, *ex post* judicial review does not provide the extent of legal certainty necessary for dispute termination.[284] Legal certainty's advantages are self-evident, these being, primarily, faster conflict resolution, enhanced predictability, lower information expenses and reduced litigation costs.[285] It is claimed that the type of impure paternalism being solicited will eliminate such difficulties for bank customers and enhance legal certainty.

Thus, it is argued that in this manner, this kind of impure paternalism will provide adequate *ex ante* and *ex post* protection precisely because it will protect bank customers both at pre-sale and post-sale stages of banking contracts, which are credence goods. Overall, it will ensure that bank customers will be able to take optimal decisions and will continue to assist customers after those decisions have been taken and implemented. Thus, such impure paternalism will safeguard financial welfare of bank customers during their entire relationship with banks, from contract signature to termination. Indeed, in ensuring financial welfare, such impure paternalism will ultimately assist in the protection of bank customers' holistic welfare. The psychological consequences, such as stress, which

[284] Atamer (n 102).
[285] Armour and others (n 131) 61.

financial distress, may bring about on customers have already been highlighted above. Thus, such impure paternalism will reduce the terrible financial and psychological consequences of the aforementioned factors should things go wrong for bank customers. This does not mean that banks should be inordinately burdened because a balance of assumption of responsibility can be achieved in terms of public goods provision and private sector responsibility. However, it is necessary to have more holistic paternalism for optimal consumer protection and welfare outcomes.[286]

Moreover, it has been noted that the *ex-ante* fallacies, which financial distress creates, are more expensive from a social welfare standpoint. Banks have an additional motivation to provide a risky financial product where they can recoup both from customers and the government, through social security, welfare, unemployment and pension benefits effected to financially distressed customers.[287] It is argued that an added benefit of the kind of impure paternalism being invoked is that it will prevent banks from gaining in this way.

Thus, it is argued that freedom of contract must be complemented by a form of impure paternalism. It is also claimed that the primary function of redistribution of wealth lies and remains in the public law domain, including taxation and public benefits. However, it is further argued that in addition to paternalistic policies that intervene in freedom of contract, there is some limited need for redistributive policies. Therefore, although the main argument of this thesis is that an impure paternalistic stance needs to be taken in customer protection, it does not exclude the merit of interventions made for redistributive purposes. On the contrary, it is argued that a limited, exceptional redistributive rationale is needed to complement paternalistic intervention for the proposal of a coherent system of finance law to provide adequate protection to bank customers.

[286] Chiu (n 67).
[287] Atamer (n 102); Oren Bar-Gill, 'The Behavioral Economics of Consumer Contracts' (2008) 92(3) Minnesota Law Review 749.

In this regard, it is worth noting that it has already been acknowledged that in regulating banks it is legitimate to impose additional layers of redistributive rules It has been claimed that the current financial system is really a public-private relationship wherein the public has a fundamental function in consistently distributing its entire faith and credit in monetary terms across the whole system. It has been further suggested that the financial system therefore essentially acts as a franchise, wherein the public serves as the franchisor and firms, which distribute its faith and credit, serve as the franchisees. The public is the one that ultimately originates and underwrites capital in the financial system. Banks are at the heart of such a franchise and are, therefore, in a uniquely privileged position. Hence, it is argued that the imposition of redistributive rules on banks is justifiable.[288]

It is therefore argued that in principle, wealth redistribution is required limitedly in certain contexts, one being to avoid financial exclusion, which will be examined in detail in Chapter 7, another being to ensure that the cost of regulating and supervising banks falls on them. The cost of enforcing rules against them should come through banks themselves and not through the taxpayer. This is already a broadly recognised principle and part of the system because they do pay a levy to fund supervision.[289] The rationale is that since they create the risks, they should pay for them. This is effectively wealth redistribution because money is taken from banks' shareholders and senior management to be given to customers, strictly speaking, to all taxpayers. The alternative would be for the levy to come out of the general state revenue, therefore, out of each taxpayer. It is emphasised that such circumstances are an exceptional, limited justification for the redistribution rationale to complement the paternalistic intervention.

[288] Robert C Hockett and Saule T Omarova, 'The Finance Franchise' (2017) 102(5) Cornell Law Review 1143.

[289] FSMA s 23; Payment Services Regulations 2009, SI 2009/209, reg 92; Payment Services Regulations 2017, SI 2017/752, reg 92; Electronic Money Regulations 2011, SI 2011/99, reg 59; Mortgage Credit Directive Order 2015, SI 2015/910, s 25(a); FCA Handbook, Fees Manual, Fees 4.2 (Obligation to pay periodic fees).

2.9 Conclusion

The above discussion demonstrates comprehensively that bank customers have a variety of factors which work against them in their relationship with banks. Hence, they require legal intervention to be mainly paternalistic and limitedly redistributive. It is asserted that the legal intervention which provides adequate bank customer protection is essentially that kind of impure paternalism which accompanies bank customers throughout their journey with banks, a kind of legal protection which provides pre-sale assistance, post-sale care and scrutinises welfare outcomes for customers in the entire bank-customer relationship. Additionally, it is recognised that, a certain degree of redistributive intervention is necessary to avoid financial exclusion of customers and to ensure that banks themselves pay for their regulation and supervision. Thus, such impure paternalism and redistribution provide adequate *ex ante* and *ex post* protection.

Hence, the next four chapters will examine in detail various aspects of the legal framework, namely the common law of contract, consumer legislation, tort law and the regulatory regime, to establish whether they provide sufficient protection and what the gaps are before presenting the proposal of synthesis in Chapter Seven. In fact, the overall argument of the thesis is that a synthesis of private law and financial regulation is required to form a coherent system of finance law for adequate bank customer protection. Such a synthesis will provide, and hence, a coherent system of finance law will incorporate, the necessary kind of impure paternalism and redistribution which is advocated in this chapter. Customers deserve adequate legal protection against banks. After all, customers are the ultimate providers of most of the liquidity in the banking sector and entire financial system thanks to their savings. Customers are also a vital driver of the economy, borrowing money from banks against future earnings to support real estate purchases and other necessary expenditure.[290]

[290] Armour and others (n 131) 205.

Chapter Three

The Limitations of Bank Customer Protection in the Common Law of Contract

3.1 Introduction

The relationship between a bank and its customer is contractual[291] and, hence, governed by contract law.[292] It is an arm's length relationship wherein each party prioritises their own interests over those of the other.[293] As argued in Chapter Two, doubtlessly, it is also marked by a significant power imbalance, with the bank being the stronger party and the customer being the weaker one. This chapter investigates the extent to which the common law of contract protects bank customers. It evaluates whether this type of law advances freedom of contract or whether it provides the kind of impure paternalism which has been proposed in Chapter Two.

This chapter enquires into the legal framework of the bank-customer relationship and argues that banks do not owe a general fiduciary duty to customers.[294] Evidence thereof are the following: the bank-customer relationship is essentially a commercial one founded

[291] *Joachimson v Swiss Banking Corpn* [1921] 3 KB 110 (CA), approved by the Privy Council in *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80.
[292] EP Ellinger, E Lomnicka and CVM Hare, Ellinger's Modern Banking Law (5th edn, Oxford University Press 2011) 131-6.
[293] *Woods v Martins Bank* [1959] 1 QB 55; *Cornish v Midland Bank* [1985] All ER 513; *Verity and Spindler v Lloyds Bank* [1995] CLC 1557; Parker Hood, *Principles of Lender Liability* (Oxford University Press 2012) para 1.06.
[294] Iris H-Y Chiu, Andreas Kokkinis and Andrea Miglionico, 'Addressing the challenges of post pandemic debt management in the consumer and SME sectors: a proposal for the roles of UK financial regulators' (2 October 2021) Journal of Banking Regulation <https://doi.org/10.1057/s41261-021-00180-2> accessed 18 February 2022.

in contract and a debtor-creditor one, in the context of bank accounts; the law respects the freedom of contract of both sides, and insertion of exclusion of liability and variation clauses in contracts are in principle permissible; banks do not have a general duty of reasonable skill and care towards customers; banks have no duty to advise unless this is specifically agreed with the customers; and banks can contract out of their implied duty of confidentiality or are allowed to disclose information provided prior consent from customers is obtained. The chapter also contends that two fundamental common law rules, which interfere with freedom of contract, essentially the doctrine of undue influence and the penalty rule, are flawed and provide only a narrow degree of *ex ante* protection.

3.2 The legal framework of the bank-customer relationship and absence of a general fiduciary duty on banks to customers

As previously stated, the bank-customer relationship is one wherein each party protects their own interests over those of the other.[295] Contract law establishes structures which aim to balance the contractual parties' interests assuming that they are equal in power. It does not account for situations wherein the parties have unequal power and offers no special protection to the weaker party in cases where there is a significant power imbalance between the parties.[296] Banks include clauses in their contracts to safeguard their interests and limit their liability. Furthermore, ordinarily, contract law is not *jus cogens*. Therefore, contractual derogation is permissible.[297] Consequently, contract law fails to strike a correct balance between banks and their customers, and to provide adequate protection to the latter.[298] Hence, contract law is an inappropriate tool for regulating the contractual relationship between banks and their customers. The

[295] *Woods v Martins Bank* [1959] 1 QB 55; *Cornish v Midland Bank* [1985] All ER 513; *Verity and Spindler v Lloyds Bank* [1995] CLC 1557; Hood (n 293) para 1.06.
[296] Ruth Plato-Shinar, 'An Angel named "The Bank": The Bank's Fiduciary Duty as the Basic Theory in Israeli Banking Law' (2007) 36(1) Common Law World Review 27.
[297] Ruth Plato-Shinar, 'The Banking Contract as a Special Contract: The Israeli Approach' (2013) 29(3) Touro Law Review 721.
[298] Sinai Deutch, 'Bank-Customer Relationship: Contractual and Consumer Aspects' in *A Book in Honour of Gad Tadesky* (Sacher Institute 1996) 163, 183.

experience gained in implementing the contractual approach to the bank-customer relationship demonstrates that effective customer protection necessitates a precise and sound agreement.[299]

Typically, banks and customers conclude diverse contracts, for instance, contracts regarding the opening of a bank account, a loan, or renting a safe. Customers who open a bank account may enter into supplementary contracts for the use of cheques, credit cards or other multifunctional cards utilised in modern electronic payment systems. Hence, a typical bank-customer relationship may be regarded as a collection of contracts with widely disparate terms. Every contract has a different role for banks. Banks may provide ongoing services in the execution of payments and receipt of money for customers under a contract linked to a bank account. In other circumstances, banks enter into a credit agreement with customers and lend money to them. When customers want to purchase or sell securities, banks can either operate as brokers or investment advisers, or banks can sell or acquire the securities directly.[300]

Despite these variances, the numerous contracts employed in the bank-customer relationship typically have comparable aspects, leading to the formation of the hypothesis that such a relationship is based on a so-called general banking contract, established when the bank and the customer make their first contact.[301] Therefore, the legal relationship between banks and customers has always been based on a contract *sui generis*.[302] Most of the contract is unwritten with the law and banks' custom supplying the implied terms.[303] There is, in fact, an unwritten banking law.[304] Banks in the United Kingdom did not have standard-form contracts in the past and the relationship's

[299] Plato-Shinar, 'The Banking Contract as a Special Contract: The Israeli Approach' (n 297).
[300] Norbert Horn, 'The Bank/customer Relationship in German and European Law' (1995) 10(3) Journal of International Banking and Financial Law 116.
[301] ibid.
[302] David Southern, 'The Liabilities and Duties of Banks to Private Customers' (1996) 11(5) Journal of International Banking and Financial Law 224.
[303] Hood (n 293) para 1.07.
[304] Southern (n 302).

boundaries were largely determined by terms that the courts inferred through time.[305] Courts have in fact been in the forefront to create banks' core responsibilities to their customers.[306] Moreover, the general banking contract is considered to have banks' standard contract terms and conditions.[307] Although banking contracts can be tailor-made to customers' needs,[308] this viewpoint has been criticised because it is ineffective in resolving specific legal issues. It has been argued that although the bank-customer relationship can be regarded in its entirety, it is more factual and economic than legal, and the duties arising therefrom must be established in connection to a specific contract, promise or pre-contractual circumstance.[309]

Thus, the bank-customer relationship is crucial because it offers a framework, albeit a shaky one, that outlines both parties' rights and obligations in their routine dealings with each other. It provides the criteria for banks' obligations to their customers.[310] The fundamental notion in the determination of these obligations and liabilities is advice. Banks are accountable if they provide advice and vice versa. The law in this field can may be summed up in the following six premises. Banks have no general obligation to provide financial advice. The fact that banks lend money to customers for a project does not constitute advice that the initiative is feasible. When customers seek and receive advice from banks, the latter owe a duty of care to the former. When advice is rendered, a special relationship is formed creating a special duty of care. In certain instances, the provision of advice that results in undue influence may be assumed. Whether the boundary has been surpassed in a specific situation or not is entirely a matter of fact.[311]

Moreover, the Financial Law Panel affirmed that banks' potential liability to customers is proportional to the extent to which the particular customers rely on the banks' claims.

[305] Ross Cranston and others, *Principles of Banking Law* (3rd edn, Oxford University Press 2017) 193.
[306] Iris H-Y Chiu and Joanna Wilson, *Banking Law and Regulation* (Oxford University Press 2019) 29.
[307] Horn (n 300).
[308] Cranston and others (n 305) 193.
[309] Horn (n 300).
[310] Hood (n 293) para 1.01.
[311] Southern (n 302).

Whether that reliance is based on an advisory contract, the existence of a fiduciary relationship or pre-contractual representation, is, to some degree, a technical question.[312] Hence, banks have express and implied duties originating from the bank-customer agreement as well as an indefinite extension of these duties in specific instances. In such instances, banks also owe a fiduciary duty to customers. When banks go beyond furnishing information and money transmission services, and provide advice, they cross the border between contractual and fiduciary duties. Hence, the critical component is advice.[313]

Therefore, it follows that there is no general fiduciary duty imposed on banks towards their customers in a bank-customer relationship.[314] The elements, which evidence this fact and which have been previously mentioned at the beginning of this chapter are discussed hereunder.

3.2.1 The contractual relationship between banks and their customers

As previously stated, the bank-customer relationship is well recognised to be essentially governed by contract law.[315] Banks now employ their own standard form contracts, which protect their interests, when negotiating with customers.[316] In relation to customers' bank accounts, the relationship is basically that of debtor and creditor.[317] When customers are in credit, they are creditors and the banks are debtors. The opposite is true when customers' accounts are overdrawn. The debtor-creditor distinction is plainly important because it allows banks to treat money deposited with them as their own and profit from it. All banks have to do is to repay an equivalent amount to customers upon demand in

[312] Financial Law Panel, *Legal Obligations of Banks* (1995) 1.
[313] *Foley v Hill* (1848) 2 HLC 28, 9 ER 1002; Southern (n 302).
[314] Chiu, Kokkinis and Miglionico (n 294).
[315] *Joachimson v Swiss Banking Corpn* [1921] 3 KB 110 (CA); *Tai Hing Cotton Mill Ltd v Liu Chong Hing Bank Ltd* [1986] AC 80; Hood (n 293) para 1.06.
[316] Cranston and others (n 305) 193.
[317] *Foley v Hill* (1848) 2 HLC 28, 9 ER 1002.

the case of a savings or current account, or at a pre-determined date in the case of a fixed deposit. This would have been forbidden by opposite categorisations of trust, agency and bailment. Trust and agency would have constrained the use of the money.[318] Bailment would have necessitated the return of the same item deposited and would not have applied to payments made by book entry into customers' bank accounts.[319]

Hence, when banks receive customers' deposits, they solely owe customers personal duties. Therefore, when money is paid to a bank under an incorrect belief that the bank is authorised to act as such, the payer cannot claim the sums paid over on the ground of being money had and received for their use. When money is ordinarily deposited with a bank, the bank takes that money absolutely. Consequently, it is not held on trust for or to the use of the depositor.[320] Likewise, when a bank furnishes a reference on a customer's credit worth, it is not acting as a fiduciary. Hence, it will only be liable in negligence for any misrepresentation and will not be liable to the customer for any damages in relation to a negative reference if the information furnished there in is correct.[321]

Notably, *Foley v Hill*[322] recognised that the bank-customer relationship is not merely a debtor-creditor one as a bank can act as a trustee or fiduciary in particular instances. This happens when the relationship calls for the bank to act as a trustee or fiduciary in some way. When a bank accepts to act as trustee for a customer, the bank essentially becomes a trustee in that scenario. When a bank receives money to be retained for a third party's benefit, it owes that third party fiduciary obligations.[323]

[318] ibid.
[319] Cranston and others (n 305) 191.
[320] *Box v Barclays Bank plc* [1998] Lloyd's Rep Bank 185.
[321] *Turner v Royal Bank of Scotland* [2001] EWCA Civ 64.
[322] (1848) 2 HLC 28, 9 ER 1002.
[323] *Rowlandson v National Westminster Bank Ltd* [1978] 1 WLR 798.

3.2.2 Freedom of contract, exclusion of liability clauses and variation clauses

In English contract law, it is universally acknowledged that, absent incapacity or illegality, contracting parties have the authority to establish mutual rights and obligations by agreement.[324] The overarching principle is that 'parties are free to contract as they may see fit'.[325] The concepts of freedom and equality are at the heart of contract law.[326] Furthermore, contract freedom, party autonomy and the requirement for commercial certainty are all key elements in English contract law.[327] English courts assume that, when creating a financial contract, the parties can protect their own interests. The parties may consent to whatever conditions they like and the courts will honour their decisions. Normally, courts will regard the express contractual provisions, or the plain wording of a contract.[328] They are reticent to read express provisions and imply terms into a contract with any presumptions about what they were meant to accomplish.[329] Therefore, courts are hesitant to interfere with how the parties have decided to reconcile their conflicting interests and transfer risk. It may be argued that courts make an exception for contracts comprising consumers,[330] whose conceived vulnerability is safeguarded through statutory consumer law.[331] However, it is arguable that courts do so to a limited extent within the confines of such law, given contractual discipline's rigidity.[332]

[324] *Photo Production Ltd v Securicor Transport Ltd* [1980] AC 827; SolËne Rowan, 'Abuse of Rights in English Contract Law: Hidden in Plain Sight?' (2021) 84(5) Modern Law Review 1066.
[325] *Suisse Atlantique SociÈtÈ d'Armement SA v NV Rotterdamsche Kolen Centrale* [1967] 1 AC 361, 399.
[326] Reinhard Zimmermann, 'Consumer Contract Law and General Contract Law: The German Experience' (2005) 58(1) Current Legal Problems 415.
[327] Richard Hooley, 'Controlling Contractual Discretion' (2013) 72(1) The Cambridge Law Journal 65.
[328] Cranston and others (n 305) 202.
[329] ibid; *Fennoscandia Ltd v Robert Clarke* [1999] Lloyd's Rep Bank 108; *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52; [2002] 1 AC 481.
[330] Rowan (n 324).
[331] Consumer Rights Act 2015.
[332] Adair Turner, *Between Debt and the Devil: Money, Credit, and Fixing Global Finance* (Princeton University Press 2016) ch 2; Dave Ramsden, 'Speech: The potential long-term economic effects of Covid' (17 November 2020), The Bank of England <www.bankofengland.co.uk/-/media/boe/files/speech/2020/the-potential-long-term-effects-of-covid-speech-by-dave-ramsden.pdf> accessed 23 June 2022.

Indeed, it has been claimed that one contract law's primary function is to limit the amount of effort, time and resources spent on disagreements over economic transaction, and the harm resulting from such disagreements. In this regard, it has been advocated that a contract law's goal should be to reduce dispute because this helps both the parties' individual interests and public interest in social harmony.[333] Furthermore, no comprehensive authority exists to nullify or modify freely negotiated contractual rights based on principles of fairness, reasonableness and good faith.[334] The acknowledgement of an implied duty of good faith in performance was contentious and subsequent instances received varied responses.[335] It has been argued that the concepts of contract freedom and party autonomy necessitate that the required standard is not an objective norm of reasonableness. When an underlying fiduciary relationship does not exist, a contracting party is not obliged to treat the other with fairness and reasonableness. Nonetheless, they must treat the other with honesty and it has never been contended that English commercial contract law concepts recommend differently.[336]

Moreover, banks may restrict their liability by including an exclusion of liability clause in their contracts with customers, limiting the latter's remedies under the law for banks' breaches. However, such provisions must be clearly stated or the *contra proferentem* rule will be applicable.[337] Additionally, banks may incorporate a variation clause entitling them to change the contract's terms unilaterally. Such clauses must also be expressed clearly.[338] There is authority that a contractual discretion to adjust interest rates during the course of a contract is subjected to an implied requirement that it must not be used incorrectly, capriciously or arbitrarily or in a way which no reasonable bank, behaving

[333] Paul MacMahon, 'Conflict and Contract Law' (2018) 38(2) Oxford Journal of Legal Studies 270.
[334] Rowan (n 324).
[335] ibid; eg *Mid Essex Hospital Services NHS Trust v Compass Group UK and Ireland* [2013] EWCA Civ 200 (CA) wherein Jackson LJ held that 'there is no general doctrine of 'good faith' in English law' [105].
[336] Hooley (n 327).
[337] see *HIH Casualty & General Insurance Ltd v Chase Manhattan Bank* [2003] UKHL 6; [2003] 1 All ER (Comm) 349.
[338] *Paragon Finance plc v Nash* [2001] EWCA Civ 1466, [2002] 2 All ER 248 (CA).

reasonably, would.[339] It has been argued that, ultimately, such judgments allude to a court mandating that such contractual discretion be employed in good faith.[340]

3.2.3 The contractual duty of care

Banks owe their customers an implied contractual duty to exercise reasonable care and skill when performing customers' banking business, for instance, when banks, as agents, pay and collect cheques on customers' behalf.[341] Given the common law rules courts have established[342] and pursuant to section 49 of the Consumer Rights Act 2015,[343] this contractual duty is implicit in the bank–customer contract. However, banks owe customers no general contractual duty of reasonable skill and care. The contractual duty of care is limited to the particular services covered by the contract[344] and any flaws in the provision of such services.[345] The acts or consequences foreseen in the contract establish the contractual duty's scope.[346] Banks tend to include a basis clause, which specifies the ground on which they are contracting with customers, in the contract, thereby restricting banks' duty of care.[347]

Notably, banks' duty of reasonable care and skill is the duty to employ a reasonable bank's care and skill when conducting the activity in question. The law does not hold banks liable for a judgment error unless such error was so significant that no reasonably

[339] ibid.
[340] Hooley (n 327); Hugh Collins, 'Implied Terms: The Foundation in Good Faith and Fair Dealing' (2014) 67(1) Current Legal Problems 297.
[341] *Selangor United Rubber Estates Ltd v Cradock (No 3)* [1968] 1 WLR 1555; *Redman v Allied Irish Bank* [1987] 2 FTLR 264; *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363; *Lipkan Gorman v Karpnale Ltd* [1989] 1 WLR 1340; Hood (n 293) para 1.41.
[342] *Westminster Bank Ltd v Hilton* (1926) 43 TLR 124; *Schioler v Westminster Bank Ltd* [1970] 2 QB 719; *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363.
[343] Consumer Rights Act 2015, s 49(1) states: 'every contract to supply a service is to be treated as including a term that the trader must perform the service with reasonable care and skill'.
[344] *Euroption Strategic Fund Ltd v Skandinaviska Enskilda Banken AB* [2012] EWHC 3127 (Comm) [264]; Cranston and others (n 305) 271.
[345] *Robinson v PE Jones (Contractors) Limited* [2011] EWCA Civ 9.
[346] Aaron Taylor, 'Concurrent Duties' (2019) 82(1) Modern Law Review 17.
[347] Cranston and others (n 305) 271.

well-informed and competent bank would have committed it.[348] Furthermore, two reasonable banks can reach opposing conclusions on the same facts without losing their right to be considered reasonable. As the court stated, '[n]ot every reasonable exercise of judgment is right, and not every mistaken exercise of judgment is unreasonable'.[349] Courts are hesitant to hold banks liable under a contractual duty of care. Much hinges on the evidence, particularly, expert testimony as to what should have been carried out in the specific situation consistent with good practice.[350] For instance, where a customer suffered loss on one of numerous securities, derivatives, or foreign-exchange transactions entered, compelling evidence of the bank's lack of care and skill is required.[351]

When banks fail to make enquiries when carrying out customers' orders, they may be in violation of their duty of reasonable care and skill. Indeed, the duty of care and the duty to execute customers' instructions may be at odds. Particular transactions are so unusual that they should raise suspicions and prompt banks to investigate. Banks cannot be regarded to have proceeded with due care if they fail to enquire.[352] In *Barclays Bank v Quincecare Ltd*[353] and *Lipkin Gorman v Karpnale Ltd*,[354] the concept was employed to the care and skill that a bank should use when paying money out of a customer's account. If the bank closes its eyes to apparent dishonesty or acts recklessly in neglecting to undertake such enquiries as an honest and reasonable bank would do in situations that arouse suspicion, it will be held accountable. Such elements as the bank's knowledge of the individual making the order, the customer's position, the sum involved, the requirement for fast transfer, the existence of distinctive characteristics and the extent and facilities for undertaking reasonable enquiries will be pertinent to liability.[355]

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[348] ibid.
[349] *Re W (an infant)* [1971] AC 682, 700.
[350] Cranston and others (n 305) 272-273.
[351] *Stafford v Conti Commodity Services* [1981] 1 All ER 691; *Ata v American Express Bank Ltd* [1998] EWCA Civ 1015 (CA).
[352] eg *Morison v London County and Westminster Bank Ltd* [1914] 3 KB 356; *Papadimitriou v Credit Agricole Corpn* [2015] UKPC 13, [2015] 1 WLR 4265 (PC, Gibraltar).
[353] *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363.
[354] *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340.
[355] ibid; *Barclays Bank plc v Quincecare Ltd* [1992] 4 All ER 363.

3.2.4 The duty to advise

Additionally, banks do not owe a general advisory duty to their customers.[356] Since the bank-customer relationship is considered to be an arm's length business relationship with each party protecting their own interests, banks may seek the best possible deal for themselves.[357] They are not obliged to advise customers on the wisdom, prudence, soundness or hazards of a transaction when customers seek financial help from them, even if they are aware of the loan's objective.[358] When banks assess the details of the transaction or project to determine whether to confer the loan or not, they do so for their own precautionary reasons as lenders, not for the customers' benefit, because their primary aim is recouping the money lent to the customers over the loan's term.[359] They assume no responsibility for the proposed transaction's viability.[360] It has been argued that, in reality, this basic rule protects banks from claims that they did not take appropriate steps to counsel or warn customers about the business sense of their transaction.[361]

Furthermore, a bank that opens an account for a customer is not required to provide advice on the risks or tax consequences of certain payments made in connection with the account.[362] Also, it does not owe an implied contractual duty under general law to advise a customer of a novel type of account providing extra facilities, for example, paying out interest, that could substitute that customer's existing, non-interest-bearing account. It

[356] *Woods v Martins Bank* [1959] 1 QB 55; *Cornish v Midland Bank* [1985] All ER 513; *Verity and Spindler v Lloyds Bank* [1995] CLC 1557; *Suriya & Douglas v Midland Bank plc* [1999] EWCA Civ 851, [1999] 1 All ER (Comm) 612.
[357] *Lloyds Bank plc v Cobb* (1991) 12 LDAB 210 (CA).
[358] *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205; *Lloyds Bank plc v Cobb* (1991) 12 Legal Decisions Affecting Bankers 210 (CA); *National Commercial Bank (Jamaica) Ltd v Hew's Executors* [2003] UKPC 51; *Finch v Lloyds TSB Bank plc* [2016] EWHC 1236 (QB); [2017] 1 BCLC 34.
[359] *Lloyds Bank v Cobb* (1991) 12 Legal Decisions Affecting Bankers 210 (CA); *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205.
[360] *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205.
[361] Chiu and Wilson (n 306) 50.
[362] *Redman v Allied Irish Bank* [1987] 2 FTLR 264.

has been claimed that, given the numerous customers a bank has, this would be too arduous and time-consuming for the bank having to do so.[363]

Moreover, banks owe no duty to furnish advice or information to the customers beyond the confines of their agreed-upon bank-customer relationship.[364] The English courts consider that imposing an obligation to advise on the inherent risks is neither justified nor necessary provided that banks do not breach the delicate line that separates the activities of the provision of information and advice.[365] Normally, banks have a duty to represent any facts fairly and truthfully but have no duty to explain or warn unless they assume responsibility as an adviser.[366] Typically, a basis clause in the bank's contract will state that the customer is not dependent on the bank for advice.[367] Absent a request, bank customers cannot rely on banks to care for their interests.[368] Furthermore, even if banks have previously rendered advice, they have no continuing obligation to maintain such advice up to date provided no general responsibility or fiduciary duty has been assumed.[369]

However, when, pursuant to a contract, banks are requested to advise customers on the soundness of a transaction or business endeavour, they are required to do so[370] with reasonable care and skill.[371] They must clarify the transaction's nature completely and accurately. In satisfying the obligation, a thorough examination of the transaction's risks and drawbacks may be necessary.[372] This does not apply to the ordinary banking

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[363] *Suriya & Douglas v Midland Bank plc* [1999] EWCA Civ 851, [1999] 1 All ER (Comm) 612.
[364] *Fennoscandia Ltd v Clarke* [1999] EWCA Civ J0118-7; [1999] Lloyd's Rep Bank 108.
[365] *Green v Royal Bank of Scotland plc* [2013] EWCA Civ 1197; [2014] Bus LR 168 (CA).
[366] *Bankers Trust International plc v PT Dharmala Sakti Sejahetra (No 2)* [1996] CLC 518, [1995] Bank LR 381; *Standard Chartered Bank v Ceylon Petroleum Corpn* [2011] EWHC 1785 (Comm), [508]; *Titan Steel Wheels Ltd v Royal Bank of Scotland plc* [2010] EWHC 211 (Comm); [2012] 1 CLC 191.
[367] *JP Morgan Bank (formerly Chase Manhattan Bank) v Springwell Navigation* [2008] EWHC 1186 (Comm); *Titan Steel Wheels Ltd v Royal Bank of Scotland plc* [2010] EWHC 211 (Comm); [2010] 2 Lloyd's Rep 92.
[368] *Lloyds Bank v Cobb* (1991) 12 LDAB 210.
[369] *Fennoscandia Ltd v Clarke* [1999] Lloyd's Rep: Banking 108.
[370] *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205; *Lloyds Bank v Cobb* (1991) 12 LDAB 210.
[371] *Morgan v Lloyds Bank plc* [1998] Lloyd's Law Rep: Banking, 73.
[372] *Cornish v Midland Bank Ltd* [1985] 3 All ER 513 (CA); *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch).

contract. Banks and customers must agree on an additional responsibility on banks for which the latter most likely collect a fee.[373] Banks can always refuse to advise customers.[374]

3.2.5 The duty of confidentiality

Further, as confirmed by the leading case *Tournier v National Provincial and Union Bank of England* (*Tournier*),[375] banks owe customers a duty of confidentiality. This obligation is an implicit provision in the bank-customer contract.[376] However, additionally, the law has a duty to safeguard confidential information in the case of prospective customers who have not yet signed a contract.[377] This duty is based on the premise that customers who entrust personal financial information to banks should have legal guarantee that the information will not be shared with anyone else.[378] Therefore, banks owe customers an obligation to maintain their financial dealings confidential for ethical and practical purposes.[379]

3.2.5.1 Qualifications to the duty

The duty of confidentiality is not absolute and four qualifications to it have been recognised. These are the ones identified by Bankes LJ in *Tournier*: (1) where disclosure is compelled by law; (2) where there is a duty to disclose to the public; (3) where the bank's interests necessitate disclosure; and (4) where the disclosure is carried out with the customer's express or implied consent.[380] Obviously, these qualifications limit the

[373] *Lloyds Bank plc v Cobb* (1991) 12 LDAB 210.
[374] ibid.
[375] *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461.
[376] ibid.
[377] Cranston and others (n 305) 257.
[378] ibid 255.
[379] Alastair Hudson, *The Law of Finance* (2nd edn, Sweet and Maxwell 2013) 899; Chiu and Wilson (n 306) 46.
[380] *Tournier* (n 375) 473.

protection that bank customers receive from the duty of confidentiality. They are broadly viewed as exceptions to the duty and as if they have legislative force.[381] They are analogous to the conditions which must be satisfied for the lawful processing of personal data under data protection law: legal obligation, the data controller's legitimate interest, public interest and the data subject's consent.[382] For the purposes of the thesis, the first qualification is discussed hereunder as it is considered to be the one most likely to undermine the duty of confidentiality and reduce significantly the protection afforded to bank customers.[383]

3.2.5.1.1 Compulsion by law

Given regulatory or judicial action, many intrusions compel banks to release confidential information. Public interest is cited as the justification for such disclosure. Investigatory or regulatory authorities are frequently given access to the confidential information which banks store on their customers in the context of banking supervision, money-laundering, terrorism, drug trafficking, insider dealing, company fraud and tax evasion.[384] Notably, the legal provisions do not totally trump confidentiality. When information is disclosed, access is limited rather than made available to the general public. Moreover, those that obtain the information are legally bound not to reveal it to anybody else. In severe doubtful circumstances, banks may pursue guidance from the court. If the court determines that the bank must disclose, the latter will be able to defend itself against a customer's subsequent action.[385]

[381] ibid p 260.
[382] Orla Lynskey, *The Foundations of EU Data Protection Law* (Oxford University Press 2015), 31-32; Regulation (EU) 2016/679 of the European Parliament and of the Council of 27 April 2016 on the protection of natural persons with regard to the processing of personal data and on the free movement of such data, and repealing Directive 95/46/EC (General Data Protection Regulation) [2016] OJ L119/1.
[383] Cranston and others (n 305) 257.
[384] ibid 262; eg Proceeds of Crime Act 2002, s 330; Terrorism Act 2000, s 21A.
[385] *Governor and Company of the Bank of Scotland v A Ltd* [2001] EWCA Civ 52, [2001] 1 WLR 751.

In the realm of judicial proceedings, compulsion by law arises because disclosure of pertinent information is crucial to decision-making. Section 7 of the Bankers' Books Evidence Act 1879 allows claimants in the United Kingdom to acquire an *ex-parte* order to investigate and copy banks' documents which may be relevant to court proceedings. A court may also employ its *Norwich Pharmacal* jurisdiction, which stems from the case of *Norwich Pharmacal Co v Customs and Excise Commissioners*,[386] to require anyone, including a bank, who has been involved in others' misconduct, to reveal all essential information and recognise the wrongdoer. For instance, in *Bankers Trust Co v Shapira*,[387] the Court of Appeal compelled a bank to reveal confidential customer information to aid a fraud victim in tracing cash.

Thus, the duty of confidentiality has been restricted.[388] In fact, it has been asserted that the duty of confidentiality has been diminished in present UK banking law to the point where the obligation is nowadays to reveal and that of confidentiality is the exception.[389] Express contractual provisions which regulate confidentiality are today being utilised in financial contracts in the United Kingdom.[390] Although bank secrecy draws legal funds, it can also prohibit the establishment of audit traceability that can be followed by investigators.[391] Hence, a balance must be struck between the significance of confidentiality and the need to curb the criminal activities which thrive on it and, in dire situations, threaten the state's institutions.[392] All this basically comes down to the reality that the implied duty of confidentiality provides some protection but this is diluted by the four qualifications, particularly compulsion by law.[393]

[386] *Norwich Pharmacal Co v Customs and Excise Commissioners* [1874] AC 133.
[387] *Bankers Trust v Shapira* [1980] 1 WLR 1274, [1980] 3 All ER 353 (CA.
[388] Howard Johnson, 'Confidentiality Diminished' (1995) International Banking and Finance Law 98.
[389] Anu Arora, *Banking Law* (Pearson 2014) 263.
[390] Cranston and others (n 305) 257.
[391] R M Antoine, *Confidentiality in Offshore Financial Law* (2nd edn, Oxford University Press, 2014) 5-7.
[392] ibid 20-2.
[393] Cranston and others (n 305) 257.

3.3 Fundamental contract law rules

Two common law rules which are exceptions to the freedom of contract, and which provide some protection to bank customers, are the doctrine of undue influence and the penalty rule. Notably, the doctrine of undue influence is an equitable principle and challenges the reality of consent. When this doctrine is contemplated, courts review a contractual obligation's fairness. However, the penalty rule, initially an equitable concept translated into a modern action for breach of contract, solely controls the remedies available for breach of a party's basic duties, not the basic duties themselves.[394] This part of the chapter analyses these two essential contract law rules and the degree of protection provided to bank customers.

3.3.1 The doctrine of undue Influence

Since the cases of *Lloyds Bank Ltd v Bundy*[395] and *National Westminster Bank plc v Morgan*,[396] it has been uncommon for a bank customer to invoke this equitable concept to argue that a bank itself has exercised undue influence to enforce a security, for example, a guarantee. Three-party lawsuits, wherein a charge's enforcement by a bank is challenged on the ground that a third party unduly influenced the bank customer to enter into the transaction, are the most common circumstances where a bank becomes embroiled in litigation.[397] Often, it is a wife who alleges that her husband unduly influenced her to hand over her interest in the marital house to a bank to receive a loan for the husband's business problems.[398] However, a case may also concern a bank

[394] *Cavendish Square Holding BV v El Makdess*i; *ParkingEye Ltd v Beavis* [2015] UKSC 67, [2016] 2 All ER 519.
[395] [1975] QB 326.
[396] [1985] AC 686.
[397] Chiu and Wilson (n 306) 71.
[398] *Barclays Bank plc v O'Brien* [1994] 1 AC 180; *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2001] 4 All ER 449.

customer who is not a wife and is emotionally, sexually or economically attached to a third party.[399]

The fundamental rule in English law is explicit when a contract has been obtained through undue influence. Bank customers who were subjected to the influence may cast aside the contract.[400] However, this doctrine does not provide adequate protection to bank customers because, while the core underlying principles concerning undue influence appear to be quite evident from afar, issues emerge when the law is assessed more carefully. Indeed, despite the fact that the doctrine is around two hundred years old and its foundation and scope were thoroughly investigated by the House of Lords in the well-known case of *Royal Bank of Scotland v Etridge (No 2)* (*Etridge*),[401] key fallacies continue.[402] Difficulties which result in the doctrine of undue influence providing inadequate protection concern the burden of proof and the categories of undue influence, the reasonable steps which a bank must take to avoid being fixed with notice, the imbalance between the bank's and the bank customer's interests, the emotional dynamics involved in undue influence and the solicitor's role. These problems are discussed hereunder.

3.3.1.1 The burden of proof and the categories of undue influence

Although there is presently some debate on how exactly undue influence cases should be classified,[403] the conventional approach is to separate them into two main categories: cases of 'actual' undue influence (Class 1) and cases where a trust and confidence relationship is either presumed to exist (Class 2A) or proven on the facts (Class 2B).[404]

[399] eg *Abbey National Bank plc v Stringer* [2006] EWCA Civ, where a son was found to have exerted undue influence over his mother.
[400] *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2001] 4 All ER 449.
[401] ibid.
[402] *Niersmans v Pesticcio* [2004] EWCA Cov 372.
[403] *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2001] 4 All ER 449, [92] (Clyde J).
[404] ibid.

The demarcation between class 2A and class 2B undue influence is purely forensic.[405] It has to do with how the claimant proves the first requirement, the special influence relation,[406] which necessitates a thorough investigation of the circumstances.[407]

3.3.1.1.1 Actual undue influence

Bank customers' possibilities of proving actual undue influence are slim in truth. To begin with, the majority, if not all, of unwarranted pressures take place in secrecy.[408] Secondly, exceptions exist for interactions that are reasonable. The bank customer may not simply depend on behaviour or statements which do not go beyond that anticipated of a reasonable husband.[409] The behaviour or statements of a reasonable husband, or wife, partner or cohabitant, are subject to courts' discretion and have been interpreted widely. The third party will be forgiven for employing hyperbolic language in predicting their business' potential and it is irrelevant if the bank customer assigned their interest despite being extremely tense.[410] Given that the test allows for a certain amount of impropriety, it favours the third party.[411]

3.3.1.1.2 Class 2B presumed undue influence

Hence, bank customers' best option is to claim Class 2B undue influence. The presumption in such circumstances is held to be no more than acknowledging that proof of the bank customer-third party relationship, together with any other evidence existing at the time, may be satisfactory to establish an undue influence finding on the balance of

[405] ibid.
[406] Rick Bigwood, 'Undue Influence in the House of Lords: Principles and Proof' (2002) 65(3) Modern Law Review 435.
[407] Godwin Tan, 'Undue Influence: The Case for a Presumption of Influence between Couples' (2018) 7 Oxford University Undergraduate Law Journal 81.
[408] Tan (n 407).
[409] *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2001] 4 All ER 449, [32].
[410] ibid [30]-[32].
[411] Tan (n 407).

probabilities. It is questionable what specifically must be proven to institute a claim under Class 2B.[412]

Allusions to confidentiality were criticised because many confidential relationships, for instance, husband and wife, did not create any presumption of undue influence. Moreover, victimisation and one party's dominance over the other party were rejected on the basis that merely demonstrating that the party in whom trust and confidence have been placed is able to exercise influence over the one who has done so is sufficient. The problem is that this may be stated in relation to practically every such relationship because it is hard to imagine how one individual can have trust and confidence in another without the latter being able to exercise a degree of influence over them.[413] Further, it is questionable whether proof of claimant-based conduct, defendant-based conduct, or both is necessary to demonstrate a relationship of trust and confidence.[414]

It has been argued that, in contrast to the popular belief that spouses or individuals in similar relationships will most likely be able to establish a sufficient influence relationship,[415] the Class 2B criterion is a *de facto* burden on these bank customers to prove such a relationship.[416] According to high court judgments, bank customers have a substantial burden to prove that a spouse or similar has sufficient influence.[417] Contrary to Lord Scott in *Etridge*, the judges in *Gorjat v Gorjat*[418] and *Re Barker-Benfield*[419] did not deem the cohabiting spouses' relationship to be *ipso facto* special. It was only a minor component of the whole situation.[420]

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[412] ibid.
[413] John Stannard, 'The Emotional Dynamics of Undue Influence' in Heather Conway and John Stannard (eds), *The Emotional Dynamics of Law and Legal Discourse* (Hart Publishing 2016) 59.
[414] Fiona Burns, 'The Elderly and Undue Influence Inter Vivos' (2003) 23(2) Legal Studies 251.
[415] Nelson Enonchong, *Duress, Undue Influence and Unconscionable Dealing* (Sweet and Maxwell 2012) 10-039.
[416] Tan (n 407).
[417] eg *Gorjat v Gorjat* [2010] EWHC 1537 (Ch), 13 ITELR 312.
[418] ibid.
[419] *Re Barker-Benfield* [2006] EWHC 1119 (Ch), [2006] WTLR 1141.
[420] Tan (n 407).

Moreover, the second requirement, namely, the transaction is not easily discernable by the relationship, caused significant difficulty to the courts[421] and adds to bank customers' burden of proof. In *Etridge*, a crucial amendment was made to the law by replacing the phrase 'manifest disadvantage' with 'transactions that call for an explanation' because the second requirement had to arouse the rebuttable presumption of undue influence.[422] Hence, in post-*Etridge* judgments, the phrase's role was diminished from substantive to evidential and was nevertheless used to determine whether a transaction required explanation.[423] When other elements are present, the presumption of undue influence may be established with no requirement to demonstrate manifest disadvantage. In *Macklin v Dowsett*,[424] the Court of Appeal affirmed that the claimant was neither required to evidence any misconduct committed by the alleged wrongdoer nor that the transaction was to their manifest disadvantage.

The preservation of the evidential function of manifest disadvantage has been critiqued since it has restricted relevance and merely obscures more the distinction between Class 1 and Class 2B undue influence.[425] This is because demonstrating manifest disadvantage follows the same steps as proving Class 1 undue influence.[426] Therefore, no distinction exists between Class 1 and Class 2B undue influence. Indeed, it has been argued that, if, as in *CIBC Mortgages v Pitt*,[427] manifest disadvantage should be repealed for Class 1 undue influence, it should be repealed for Class 2B undue influence as well.[428]

[421] Dov Ohrenstein, 'Undue Influence and Duress' (Radcliffe Chambers) <www.radcliffechambers.com/wp-content/uploads/2019/11/Undue_Influence_and_Duress-DO.pdf> accessed 23 June 2022.
[422] *Allcard v Skinner* (1887) 36 Ch D 145.
[423] Edwin C Mujih, 'Over ten years after Royal Bank of Scotland Plc v Etridge (No.2): is the law on undue influence in guarantee cases any clearer?' (2013) 2 International Company and Commercial Law Review 57.
[424] [2004] EWCA Civ 904, [2004] 2 EGLR 75.
[425] Andrew Phang and Hans Tjio, 'The Uncertain Boundaries of Undue Influence' (2002) Lloyd's Maritime and Commercial Law Quarterly 231.
[426] Ibid.
[427] [1994] 1 AC 200, [1993] 4 All ER 433.
[428] Mujih (n 423).

Importantly, formal equality should not be confused with substantive equality. It has been contended that 'whatever their formal equality, women were and, in general, remain not equal in fact'.[429] While formal equality may frequently be inspiring, exorbitant attention to ensure formal equality in law may jeopardise substantive equality. This occurs when courts ignore disadvantaged groups' *de facto* inequalities and refuse to help them to ensure formal equality. It is arguable that despite the inclusion of wives in Class 2A category may seem paternalistic to elite and strong-minded women, it recognises the hard truth that many women remain at extreme risk of being unduly influenced by their husbands in financial matters. Whereas it is important to avoid labelling women as victims, the experiences of a select few should not be assumed to be representative of all women. The recognition of the practical reality of vulnerable wives may readily exceed concerns on paternalism of elite and strong-minded.[430] It is also unclear why wives are discriminated against fiancées and fiancés are distinguished from fiancées. Furthermore, it is questionable why a presumption exists in the situation of an underage child where the ascendant party is a parent but not a grandparent or older sibling, and why the presumption ends when the child reaches the age of maturity.[431]

The doctrine of undue influence is aimed at restraining unfair advantage-taking, exploitation, or victimisation in interpersonal transactional engagements.[432] It is not intended to alleviate irresponsible, foolish, excessive or imprudent individuals from regrettable purchases or bad bargains.[433] The doctrine is subject to the freedom/liberty concept, that is, an individual is free to dispose of their property as they please.[434] However, it also helps to determine what liberty signifies in this context by referring to the process whereby the third party may lawfully obtain or accept the bank customer's consent in relation to equity's conscience. Substantive unfairness does not form part of

[429] Rosemary Auchmuty, 'Unfair Shares for Women' in Hilary Lim and Anne Bottomley (eds), *Feminist Perspectives on Land Law* (Routledge 2014) 177.
[430] Tan (n 407).
[431] Ohrenstein (n 421).
[432] *Allcard v Skinner* (n 422).
[433] Bigwood (n 406).
[434] *Allcard v Skinner* (n 422).

this definition.[435] It is solely useful to prove wrongdoing.[436] As aforementioned, undue influence implies impropriety. According to the law, undue influence denotes that influence has been abused.[437]

3.3.1.2 The Reasonable Steps to be taken by the Bank and the Solicitor

The bank must always take reasonable steps to explain the risks that the bank customer is taking by acting as surety. This is a minor burden for banks, as it is no more than would be required of a creditor who has a personal guarantee. The measures may seem extensive and protective of the bank customer at first glance. On closer inspection, however, they appear to be little more than a formalistic procedure for obtaining written certification from a bank customer's solicitor that the solicitor has thoroughly clarified the documents' contents and the practical ramifications for them.[438] They are simply a way to safeguard the bank by neutralising the situation.[439] In this regard, it has been alleged that the steps a bank must take after being placed on enquiry seem to give it an excessively robust protection by allowing it to rest on a solicitor's certificate.[440]

The solicitor's responsibility is substantially to ensure that the bank customer comprehends the transaction's nature and effect and is willing to participate in it. It is not

[435] *CIBC Mortgages plc v Pitt* [1994] 1 AC 200, [1993] 4 All ER 433, confirmed in *Etridge.*
[436] Rick Bigwood, 'Contracts by Unfair Advantage: From Exploitation to Transactional Neglect' (2005) 25(1) *Oxford Journal of Legal Studies* 65; Mindy Chen-Wishart, 'Undue Influence: Vindicating Relationships of Influence' (2006) 59(1) Current Legal Problems 231.
[437] *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2001] 4 All ER 449.
[438] Hudson (n 379) para 24-71; see Lexis PSL Banking and Financial Practical Guidance, 'Independent legal advice (Etridge) – checklist for a lender taking third-party security from an individual and checklist for a solicitor advising an individual in relation to granting third-party security' <www.lexisnexis.com.document.linkHandler> accessed 23 June 2022; LexisNexis, 'Independent legal advice letter (Etridge letter) to be given by a solicitor: for use where a home is charged to secure a loan' <www.lexisnexis.co.uk/legal/precedents/independent-legal-advice-letter-etridge-letter-to-be-given-by-a-solicitor-for-use-where-a-home-is-charged-to-secure-a-loan> accessed 23 June 2022.
[439] Zhong Xing Tan, 'Where the Action Is: Macro and Micro Justice in Contract Law' (2020) 83(4) Modern Law Review 725.
[440] Shane Ryan O'Brien, 'Symptoms of Insecurity: Banks, Sureties and Third Party Undue Influence' (2005) 69(5) University College Dublin Law Review 83.

to ensure that the bank customer's approval was obtained without undue influence. It is arguable that this destroys the process's entire purpose. Surprisingly, the bank customer's solicitor may also represent the bank or third party.[441] This calls into question whether counsel is actually impartial.[442]

Banks' bad practices are also a concern.[443] In this context, Pawlowski and Greer discovered that only 38 percent of banks demanded to meet a surety privately and 79 percent for a wife to seek independent legal advice, based on a questionnaire handed out to 117 banks years after O'Brien, with a 52.1 percent response rate. Despite the authors' conclusion that the O'Brien guidelines were ordinarily being followed, there were yet 21 percent of wives that were not referred to independent legal counsel and the percentages for cohabitees and family members were worse.[444]

Further, another issue is solicitors' sheer incompetence.[445] The quantity of poor practice or malpractice by solicitors, for instance, verifying that advice was rendered when none was seemingly furnished[446] or delivering inadequate and poor advice,[447] is a conspicuous characteristic of undue influence cases. Judges have demonstrated that they have enormous faith in the legal profession and have frequently permitted banks to believe that the surety obtained proper legal advice.[448] This is, perhaps, the way it should be but,

[441] *Royal Bank of Scotland v Etridge (No 2)* [2001] UKHL 44; [2001] 4 All ER 449.
[442] Chiu and Wilson (n 306) 70.
[443] *Barclays Bank v Khaira* [1993] 1 FLR 343; *Barclays Bank plc v O'Brien*; *National Westminster Bank plc v Amin* [2002] UKHL 9, [2002] 1 FLR 735; *First National Bank plc v Achampong* [2003] EWCA Civ 487, [2003] 2 P & CR D33; *UCB Corporate Services Ltd v Williams* [2002] EWCA Civ 555, [2002] 2 P & CR D33.
[444] Marc Pawlowski and Sarah Greer, 'Constructive Notice and Independent Legal Advice: A Study of Lending Institution Practice', (2001) Conveyancer and Property Lawyer 229.
[445] Rosemary Auchmuty 'Men Behaving Badly: An Analysis of English Undue Influence Cases' (2002) 11(2) Social and Legal Studies 257
[446] *UCB Home Loans Corp Ltd v Moore* in *Royal Bank of Scotland v Etridge (No 2)* [1998] 4 All ER 705; *Midland Bank plc v Wallace*, in *Royal Bank of Scotland v Etridge (No 2)* [1998] 4 All ER 705; *Scottish Equitable Life plc v Virdee* [1999] 1 FLR 863.
[447] *Massey v Midland Bank plc* [1995] 1 All ER 929; *Bank of Baroda v Rayarel* [1995] 2 FLR 376; *Barclays Bank plc v Caplan* [1998] 1 FLR 532; *UCB Corporate Services Ltd v Williams* (n 443); *Bank of Scotland v Hill* [2003] EWCA Civ 1081, [2002] 29 EG 152 (CS); and *Kapoor v National Westminster Bank plc* [2010] EWHC 2986 (Ch), [2011] BPIR 836.
[448] eg *Bank of Baroda v Rayarel* [1995] 2 FLR 376.

unfortunately, not all solicitors are incompetent. Indeed, Lord Justice Millett himself asserted that this assumption was unreasonable.[449]

Additionally, while a bank is normally permitted to presume that a solicitor has performed their obligations correctly, it is difficult to discern why the bank should be allowed to draw this presumption when it is cognisant that the solicitor was unable to do so. For instance, the bank is conscious that the solicitor has not requested the financial information necessary to perform their *Etridge* duties adequately and has no basis to believe that any other competent professional would have done so. Another scenario is that the bank customer refuses to seek independent advice after being urged to do so. The bank customer cannot afterwards claim that they have the right to put the mortgage on hold. It is also possible that the bank customer's decision not to seek independent advice was itself concluded following undue influence.[450]

It is questionable how the protection will be applied in practice to lesbian, gay, bisexual, transgender, queer or long-term cohabitation (marriage-like) couples, who are similar to married couples in many ways. Whereas married heterosexual couples may experience a gendered power relationship that makes undue influence more probable, all individuals, whether heterosexual or not, in long-term romantic relationships are particularly vulnerable to the kinds of pressures which frequently correspond to undue influence, such as emotional ties and economic entrapment.[451] Furthermore, a bank is put on enquiry under the *Etridge* rules solely when it is cognisant of the relationship between the bank customer and the third party. However, given many individuals' incapability to identify a homosexual couple if they encounter one as well as many gays and lesbians' unwillingness to expose themselves to outsiders for fear of a homophobic reaction, it is plausible that a bank would object to the lack of notice if such an issue went to court.[452]

[449] Peter J Millett, 'Equity's Place in the Law of Commerce' (1998) 114(2) Law Quarterly Review 214.
[450] Elizabeth Ovey, 'Secured indebtedness, set-off and enforcement: the law after Woodeson v Credit Suisse' (2019) 34(2) Journal of International Banking and Financial Law 85.
[451] Tan (n 407).
[452] Auchmuty, 'Men Behaving Badly: An Analysis of English Undue Influence Cases' (n 445).

3.3.1.3 The Emotional Dynamics involved in Undue Influence

Another obstacle which prevents the doctrine of undue influence from adequately protecting bank customers is the emotional component. Bank customers may consent to a contract for many reasons. However, three emotions are especially important in this context, namely, fear, hope and love. Bank customers may be afraid of the consequences if they object to the agreement, or may be pressurised to agree, or may do so influenced by the affection that exists between the third party and themselves. Emotions are motivations and emotional conduct may be adequate and rational simultaneously. Emotions can sometimes fully override the will. When they do not, they nonetheless prepare bank customers to behave in a certain manner and not another. The more they are predisposed, the more likely that they will act in such a way with no conscious employment of their will.[453]

It is, therefore, not surprising that Fehlberg discovered that, while some women who were convoluted in undue influence cases were aware of what they were doing, they were nevertheless incapable of withholding their approval to the mortgage. Others were adamant that they would have never refused, regardless of the advice, due to their financial or emotional reliance on the third party, fearfulness of their husband's domineering or a need to demonstrate loyalty in their marriage. According to Fehlberg, judges significantly trivialise the financial and emotional reasons as to why women furnish security.[454]

One serious repercussion is that if the court refuses a claim of undue influence because it decides that the bank customer would have nonetheless agreed to act as surety, regardless of the advice, because they trusted the third party's capability to make the business succeed, the bank customer will be barred from suing the bank and/or solicitor

[453] Stannard (n 413).
[454] Belinda Fehlberg, *Sexually Transmitted Debt: Surety Experience and English Law* (Oxford University Press 1997) 75.

for negligence, this being their only ultimate hope for remedy.[455] Given that the bank customer would have ignored the advice anyway, neither the bank nor the solicitor would be held accountable for the advice provided or not provided. Hence, if the aim of the doctrine of undue influence is to protect the vulnerable from exploitation, it is fundamentally flawed.[456] Further, it is plausible that notwithstanding that a solicitor performs their obligation correctly and the bank customer comprehends the transaction's practical consequences, the latter may nevertheless be subjected to undue influence and believe they have no choice but to agree to act as surety.[457] It is evident that legal independent advice is insufficient. It is suggested that changes in law and policy, which address issues such as the availability of the family home as security for business loans, and exploration of alternatives could furnish women, and bank customers in general, better protection than the House of Lords' instructions in *Etridge*.[458]

Thus, given the above discussion, it is arguable that the doctrine of undue influence provides inadequate protection to bank customers. Moreover, it is arguable that the doctrine only provides a narrow degree of *ex ante* protection. This is because, first, it is primarily applicable in the tightly defined circumstances where bank customers furnish a security or guarantee for a spouse's or close relative's debt. Secondly, the doctrine essentially obliges banks to ascertain that the bank customers who furnish the security or guarantee have obtained appropriate legal advice before signing the relative contract.[459]

[455] *Barclays Bank plc v Caplan* [1998] 1 FLR 532.
[456] Auchmuty, 'Men Behaving Badly: An Analysis of English Undue Influence Cases' (n 445).
[457] Chiu and Wilson (n 306) 71.
[458] Auchmuty, 'Men Behaving Badly: An Analysis of English Undue Influence Cases' (n 445).
[459] Chiu, Kokkinis and Miglionico (n 294).

3.3.2 The penalty rule

It is well established that penalty clauses are invalid and, therefore, any such clauses in a bank-customer contract are unenforceable. However, the penalty rule provides inadequate protection to bank customers for three main reasons. First, recently, the UK Supreme Court effectively tightened the test for the penalty rule thereby making it harder for the customers to escape from the contract's provision. Secondly, a penalty clause can be so well drafted that it can be masked as a valid and enforceable default clause or liquidated/agreed damages clause. Thirdly, a drive was initiated to abolish the penalty rule altogether. These factors are discussed hereunder.

3.3.2.1 Strict test for the penalty rule

In the United Kingdom, since *Dunlop Pneumatic Tyre Company Ltd v New Garage and Motor Company Ltd* (*Dunlop*),[460] the law relating to the validity and unenforceability of prescribed contractual amounts of money has centred around the dichotomy between unenforceable penalties which are *in terrorem* on the one hand and enforceable liquidated damages which are genuine pre-estimates of loss on the other.[461] In fact, the *Dunlop* test disallowed numerous currency restrictions in the commercial world because they were considered penalties rather than genuine pre-estimates of damages.[462] Thereafter, the English courts started to deftly skirt the *Dunlop* rule to preserve contractual clauses that appeared to have an undeniable commercial basis.[463]

[460] [1914] UKHL 1.
[461] Shivprasad Swaminathan, 'A centennial refurbishment of Dunlop's emporium of contractual concepts: *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* [2015] UKSC 67' (2016) 45(3) Common Law World Review 248.
[462] ibid.
[463] *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* (*Cavendish*) [2015] UKSC 67 [25].

As highlighted in *Murray v Leisureplay plc*,[464] there is a tendency to uphold commercial contracts to render certainty. It is presumed that commercial parties are best positioned to determine the implications of a breach of contract. Moreover, despite a provision necessitating payment on breach of contract does not cater for a pre-estimate of loss, or is deterrent in nature, does not signify that it is penal and unenforceable.[465]

Thus, in *Lordsvale Finance plc v Bank of Zambia* (*Lordsvale*),[466] Colman J held that a clause for the payment of money in the event of a breach of contract cannot be classified as a penalty merely because it is not a real pre-estimate of damages. He observed that there was:

> no reason in principle why a contractual provision, the effect of which was to increase the consideration payable under an executory contract upon the happening of a default, should be struck down as a penalty if the increase could in the circumstances be explained as commercially justifiable, provided always that its dominant purpose was not to deter the other party from breach.[467]

Therefore, when an increased rate of interest applies only from the default date or beyond, a clause for a reasonable increase in the rate will not be overruled as a penalty and, hence, the default interest clause will be wholly enforceable.[468] In *Murray v Leisureplay plc* (*Murray*),[469] Arden LJ remarked that the contested provision benefitted both parties and that evidence was not presented to indicate that the clause was deficient from a commercial basis. It has been claimed that both Colman J in *Lordsvale* and Arden LJ in *Murray* were willing to justify a commercial basis as being a component of the test and regarded it as proof that the clause in question was not aimed to deter.[470]

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[464] *Murray v Leisureplay plc* [2005] EWCA Civ 963, [2005] IRLR 946.
[465] Cranston and others (n 305) 205.
[466] [1996] QB 752, 762G (Colman J), approved by the Court of Appeal in *Yapimcilik v United International Pictures v Cine Bes Filmcilik VE* [2003] EWCA Civ 1669,[2003] All ER (D) 312 (Nov); *Murray v Leisureplay plc* [2005] EWCA Civ 963, [2005] IRLR 946; *Euro London Appointments Ltd v Claessens International Ltd* [2006] EWCA Civ 385, [2006] 2 Lloyd's Rep 436, [2006] All ER (D) 79 (Apr).
[467] *Lordsvale Finance plc v Bank of Zambia* [1996] Q.B. 752, 763-764; [1996] 3 All ER 156, 167.
[468] Ibid.
[469] [2005] EWCA Civ 963, [2005] IRLR 946.
[470] Swaminathan (n 461).

Eventually, English courts became more lenient in enforcing liquidated damages provisions where the commercial justification requirement was met.[471] In *Alfred McAlpine Capital Projects Ltd v Tilebox Ltd*,[472] Jackson J asserted that the 'rule about penalties is an anomaly within the law of contract' and, 'in the case of commercial contracts freely entered into between parties of comparable bargaining power', a forceful disposition to defend the contractual provision exists.[473] Hence, commercial justification was inserted into the range of contractual provisions as supposedly forming another distinguishable category, together with penalties and liquidated damages. It is arguable that, while the aim pursued by this compromise was comprehensible from a practical standpoint and seemingly accomplished a degree of reconciliation with the taxonomically problematic *Dunlop* test, the rationale employed was conceptually shaky.[474] The reasoning provided was that provisions with a robust commercial basis could not be regarded as penal. However, this is incorrect because 'commercial justification' and 'penalty' can hardly be mutually exclusive categories. There may be commercially reasonable provisions that are *in terrorem* and, therefore, penal.[475]

Moreover, in the conjoined appeals of *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Ltd v Beavis (Cavendish)*,[476] the Supreme Court challenged the conventional penal-compensatory dichotomy, acknowledging that it was an 'artificial categorisation'.[477] The court held that such categories were neither 'natural opposites' nor 'mutually exclusive'[478] because a clause for an agreed amount may 'be neither or both'.[479] The court clarified that when a contractual clause is contested, the question is whether the clause is penal rather than whether it is a genuine pre-estimate of loss as the latter

[471] Maree Chetwin, 'Comparative analysis of some aspects of assessment of damages for contractual breaches in England and Wales, Australia and New Zealand' (2011) 3(2) Integrated Journal of Business and Economics 113.
[472] [2005] BLR 271.
[473] ibid 280.
[474] Swaminathan (n 461).
[475] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67.
[476] ibid.
[477] ibid [36].
[478] ibid [31].
[479] ibid.

determination provides no benefit.[480] Thus, the court smashed the penal-compensatory dichotomy and eliminated the concept of liquidated damages from consideration.[481]

In *Cavendish*, the Supreme Court reviewed the penalty rule[482] and established a novel test which emphasises the justifiable interest of the party looking to implement the provision. Lord Dunedin's definition of a penalty in *Dunlop* as a provision which provides for the payment of an amount larger than 'a genuine pre-estimate of loss' is ordinarily not applicable anymore. In a nutshell, it is a test of unconscionability and extravagance, and contains two key components. In *Cavendish*, the Supreme Court explained that whether a contractual clause is penal should be decided by considering whether the 'means by which the contracting party's conduct is to be influenced are "unconscionable" or "extravagant" by reference to some norm' and not by the consequence that it brings about on the party.[483] According to Lord Hodge, the 'norm' is 'the broader test of exorbitance or manifest excess compared with the innocent party's commercial interests' or 'innocent party's interest in the performance of the contract'.[484] Therefore, a rigorous obstacle must be cleared prior to concluding that the provision is disproportionate in character.[485]

The fundamental amendment is that a legitimate interest was adopted as the novel benchmark for determining the relevant loss to be contrasted to the amount of agreed damages, while the necessity for a significant extent of disproportionality between the two has been retained.[486] The interest need not be commercial but may be non-commercial or social. The crucial distinction is that the required legitimate interest expands over a simple concern for reimbursement for losses incurred consequent to the breach of

[480] ibid.
[481] Swamninathan (n 461).
[482] SolËne Rowan, 'The "Legitimate Interest in Performance" in the Law on Penalties' (2019) 78(1) The Cambridge Law Journal 148.
[483] *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* (*Cavendish*) [2015] UKSC 67, [31].
[484] ibid [255].
[485] Roger Halson and Qiao Liu, 'Agreed Damages, the Penalty Rule, and Unfair Terms: An Anglo-Australian and Chinese Comparison' (2019) 7(1) Chinese Journal of Comparative Law 49.
[486] ibid.

contract.[487] The test is to discern whether the disputed clause comprises a secondary obligation that imposes a disproportionate harm to the party breaching the contract relative to any innocent party's legitimate interest in the enforcement of the primary obligation.[488] A provision relating to a secondary duty is within the penalty rule's jurisdiction whereas a provision regarding a primary duty is not.[489] Nonetheless, the legitimate interest's exterior limitations were not demarcated well.[490]

Thus, the insertion of deterrent clauses in contracts is nowadays permitted.[491] They are not penal when a contracting party has a legitimate interest to influence the other contracting party's behaviour which interest was not met by the simple right to claim damages for breach of contract.[492] All arguments for expanding the penalty jurisdiction to examine clauses which demand certain amounts to be paid or foregone, or certain acts to be carried out, based on factors other than the payer or transferor's breach of contract, were flatly rejected by the Supreme Court. It did this even though it was cognisant that the Law Commission had addressed the issue in its working paper on penalty clauses. The Law Commission had rightly recognised the difficulty as being how to determine the extent of review in a manner which does not expose each contractual provision necessitating the payment of money to examination. It had concluded that the penalty rule should be applicable whenever the contested contractual clause's intention is to ensure the action or effect which is the contract's real purpose.[493]

Thus, the Supreme Court essentially restricted the test for a penalty clause by making it more difficult for a contracting party to avoid the contract's clause.[494] The penalty rule

[487] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [32].
[488] ibid.
[489] Jonathan Morgan, 'The Penalty Clause Doctrine: Unlovable but Untouchable' (2016) 75(1) The Cambridge Law Journal 11.
[490] Halson and Liu (n 485).
[491] Morgan (n 489).
[492] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67.
[493] Law Commission, *Penalty Clauses and Forfeiture of Moneys Paid* (Law Com No 61, 1975) para 10.
[494] Halson and Liu (n 485).

established in *Cavendish* is distinguished by a test which focuses on the validity, or enforceability, of the clause in question.[495] *Cavendish*'s new penalty test aims to attain a workable compromise between contract freedom and the parties' ability to agree on determined amounts of money on one end, and the protection of weak parties from extravagant or unconscionable clauses on the other.[496]

Furthermore, the Supreme Court challenged the presumption that a clause which has a commercial justification cannot serve as a deterrent. It argued that a clause's penal nature is determined by its objective, which is usually deduced from its effect, and proof of the commercial basis is obviously normally relevant thereto. Yet, proof of actual intention cannot be relied upon for the same reason. Indeed, in shattering the penal-compensatory dichotomy, the Supreme Court in *Cavendish* also made obsolete the issue that had contributed to the creation of the commercial justification category. Cases that previously qualified under this conceptually difficult category would now be readily handled under Cavendish's novel interest test.[497]

Although the Supreme Court ostensibly recognised the penalty rule established in Dunlop, it modified it in such a way that the original rule exists solely in title. The enquiry into whether the disputed provision is a genuine pre-estimate of loss and, therefore, a liquidated damages clause, was rendered pointless. Instead, a penalty was redefined as a provision which is unconscionable in regard to the protected 'interest', whether or not *in terrorem*. In practice, the new test functions similarly to a test of 'reasonableness' of prescribed quantities. Nevertheless, theoretically, the new test remains based on a disputable difference between primary and secondary duties.[498]

[495] ibid.
[496] Swaminathan (n 461).
[497] ibid.
[498] ibid.

Notwithstanding, three main arguments have been advanced to defend the novel test and the penalty rule as adopted in Cavendish.[499] The first one stems from the prior and presumed commitment to contract freedom, which ensures the parties' maximum contractual self-determination rights. Extending the penalty rule's reach would restrict the parties' freedom to an unacceptably high extent.[500] The second argument emanates from the problem of identifying the limitations of a broader scope of review.[501] The third argument draws from Lords Neuberger and Sumption's basic distinction between the court's jurisdiction to examine a primary duty's fairness and its jurisdiction to prescribe the remedy for this duty's breach.[502] It has been contended that, despite such a distinction may be hard to ascertain, the application of the penalty rule must be founded on a breach of contract.[503] However, it is arguable that an unavoidable conclusion derived from these arguments is that a possibility has been developed for provisions concerning contractual duties to be drafted and structured in such a manner that escape the penalty jurisdiction.[504]

Moreover, notably, although the concept of 'legitimate interest in performance' is crucial to the novel test on penalty clauses, and, hence, considerably practically important, the Supreme Court in *Cavendish* did not define it. It has been argued that it only provided broad guidelines to understand what may or may not comprise a legitimate interest. Thus, the injured party's legitimate interest is to enforce the primary obligation or an adequate alternative to performance, particularly, where compensatory damages' recovery will be unsatisfactory. The interest's nature and scope fluctuates, depending on the circumstances. A damages clause unrelated to loss and intended to dissuade breach may be justified where the injured party has an interest beyond mere compensation.[505]

[499] Halson and Liu (n 485).
[500] *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* [2015] UKSC 67, [33], [43].
[501] ibid [14], [43].
[502] Ibid [13].
[503] Halson and Liu (n 485).
[504] see *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.
[505] *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* [2015] UKSC 67, [28]-[32], [99], [152], [255].

There is no such legitimate interest to punish the defaulting party.[506] Compensation supports appropriately the injured party's legitimate interest in many instances.[507] The purpose of the court's examination into the legitimate interest is to decide on the best course of action following the defaulting party failing to deliver. It aims to determine if compensation is sufficient to satisfy the injured party's interest in performance or whether a remedial solution extending beyond compensation is required.[508]

Absent explicit judicial direction, the penalty rule's modification encompassing the necessity of a legitimate interest presents concerns. It is questionable what a legitimate interest in performance beyond compensation is; which factors should be considered when deciding whether such an interest exists or not; and in which situations it is likely that the interest will be established. These issues will surely occur in practice, especially where damages clauses strive to attain broader non-compensatory goals rather than mere compensation.[509]

It has been argued that, where damages clauses are aimed to be compensatory, the core criterion for determining their legality is loss. Therefore, the procedure carried out by the courts prior to *Cavendish* of reconciling the prescribed sum to the foreseeable loss consequent to breach remains applicable. A compensatory clause is a penalty and unenforceable where the agreed sum of damages is extravagant or entirely unreasonable compared to 'the highest level of damages that could possibly arise from the breach'.[510] The primary function of compensation in remedies which originate by operation of law is compatible with the fact that the injured party's legitimate interest seldomly extends beyond compensation. Compensatory damages are first on the list of breach-of-contract remedies.[511] The most effective and acceptable approach to protect the injured party's

[506] ibid [32], [243], [255].
[507] Ibid [32], [255].
[508] Rowan, 'The "Legitimate Interest in Performance" in the Law on Penalties' (n 482).
[509] ibid.
[510] *Cavendish Square Holding BV v Talal El Makdessi* and *ParkingEye Limited v Beavis* [2015] UKSC 67, [255].
[511] Andrew Burrows, 'Damages for Breach of Contract: A Developing Hierarchy?' (2003) 35 Bracton Law Journal 28.

contractual aspirations is to compensate them for their losses. The issue of whether another remedial approach would be more appropriate emerges only when compensation fails to meet their aspirations.[512]

It has been contended that *Cavendish* and other cases may be used to deduce the factors which are most likely to be relevant to the legitimate interest test for agreed damages clauses. These include the broken term's importance and the seriousness of the breach's effects on the injured party, the breach's impact on third parties' interests, the public interest's protection, non-financial expectations' protection, and the parties' characteristics.[513] Furthermore, it has been claimed that the new penalty rule's requirement of a legitimate interest in performance which extends beyond compensation is unclear. In *Cavendish*, the Supreme Court failed to explain it in much detail and its scope is free to speculation. Legitimate interest concepts which featured in other circumstances, particularly, the right to affirm following a repudiatory breach,[514] specific performance[515] and gain-based damages,[516] can provide guidance. Nevertheless, analogies can only do so much, partly since uncertainty also exists on the requirement in certain situations.[517]

So far, post-*Cavendish* judgments concentrated mostly on other features of the novel test, especially the difference between primary and secondary duties[518] and the necessity for the detriment invoked by the relevant provision to be unconscionable compared to the

[512] Rowan, 'The "Legitimate Interest in Performance" in the Law on Penalties' (n 482).
[513] ibid.
[514] *White and Carter (Councils) Ltd v McGregor* [1962] AC 413, [1961] 3 All ER 1178; *Isabella Shipowner SA v Shagang Shipping Co Ltd* (The 'Aquafaith') [2012] EWHC 1077 (Comm), [2012] 1 CLC 899.
[515] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [29], [30].
[516] *Attorney General v Blake* [2001] 1 AC 268 (HL).
[517] Rowan, 'The "Legitimate Interest in Performance" in the Law on Penalties' (n 482).
[518] eg *Richard v IP Solutions Group Ltd* [2016] EWHC 1835 (Ch); *Hayfin Opal Luxco 3 SARL v Windermere VII CMBS plc* [2016] EWHC 782 (Ch); *BHL* [2017] EWHC 1871 (QB).

legitimate interest being safeguarded.[519] Courts need to articulate the requirement's scope clearly so that contracting parties can understand it well and apply it predictably.[520]

3.3.2.2 Masking of the penalty clause

Indeed, penalty clauses can be so well expertly designed that they can be hard to identify from other valid and acceptable agreed-upon damages clauses. In fact, as Lords Neuberger and Sumption acknowledged in *Cavendish*, ascertaining the test for differentiating between penal and other clauses has long been a struggle even for the most capable judges.[59] The split between between Lord Hodge and the majority in the Cavendish appeal over whether a relevant clause constituted a primary obligation or a secondary obligation, which governed a breach's implications, signifies that the penalty rule's borders will stay ambiguous.[521] Moreover, all the judges themselves noted that the doctrine can be 'circumvented by careful drafting'.[522]

Penalty clauses can be so carefully and craftily constructed that they can be interpreted as a valid default or agreed damages clause. In other words, it can be stated that a default clause and liquidated damages clause are just another term for a penalty clause, as exemplified by *Office of Fair Trading v Abbey National plc (Abbey National)*.[523] In this case, the banks' contracts were able to entirely escape the applicability of the penalty rule given that the relevant provisions were drafted in such a way that the contested charges were not made contingent on customers' breach of contract. Despite the charges incurred for unauthorised overdrafts were 'akin to default charges which are triggered by a breach of contract',[524] the banks' contracts were constructed such that the charges

[519] eg *First Personnel Services Ltd v Halfords Ltd* [2016] EWHC 3220 (Ch.); *Hayfin Opal Luxco 3 SARL v Windermere VII CMBS plc* [2016] EWHC 782 (Ch); BHL [2017] EWHC 1871 (QB).
[520] Rowan, 'The "Legitimate Interest in Performance" in the Law on Penalties' (n 482).
[521] Morgan (n 489).
[522] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [257].
[523] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.
[524] *Office of Fair Trading v Abbey National plc* [2009] EWCA Civ 116, [107].

could not be quashed as unenforceable penalties at common law. The overdrafts were unauthorised in the sense that they had not been pre-approved but the implied requests, typically, merely spending money above the agreed-upon limits, did not comprise a breach of contract. The contest to the charges fell as a result of the law existing at that time, which stated that unless the customer breaches the contract, the penalty rule is not triggered.[525] Hence, the UK Supreme Court upheld the overdraft costs.[526]

Contrastingly, in *Andrews v Australia and New Zealand Banking Group Ltd,*[527] whose facts were akin to those of *Abbey National*,[528] the Australian High Court came to the opposite conclusion, deciding that the penalty rule applied to charges for the said unauthorised borrowing. However, in *Cavendish*, this Australian High Court decision was critiqued as being faulty and repudiated in terms of both principle and authority[529] because it relied unduly on older English law, particularly penal bond judgments, which are nowadays irrelevant.[530]

Nonetheless, coincidently, around nine months after the *Cavendish* decision, in *Paciocco v Australia and New Zealand Banking Group (Paciocco)*,[531] the Australian High Court affirmed that a late payment fee did not amount to a penalty. *Paciocco*'s facts are likewise similar to *Abbey National*'s.[532] In *Paciocco*, the court had to decide whether a late payment fee imposed by the Australia and New Zealand Bank (ANZ Bank) on customers who failed to pay a minimum amount by the due date indicated on their bank statements, was invalid because it constituted a penalty. The court acknowledged that the customer's

[525] *Export Credits Guarantee Department v Universal Oil Products Co* [1983] 2 All ER 205, [1983] 1 WLR 399; Halson (2019).
[526] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.
[527] *Andrews v Australia and New Zealand Banking Group Ltd* [2012] HCA 30, (2012) 247 CLR 205.
[528] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.
[529] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [41], [42].
[530] JW Carter and others, 'Contractual Penalties: Resurrecting the Equitable Jurisdiction' (2013) 30(2) Journal of Contract Law 99.
[531] *Paciocco v Australia and New Zealand Banking Group* [2016] HCA 28, (2016) 333 ALR 569.
[532] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.

duty to pay the late payment fee was a result of their breach of contract.[533] The Australian High Court, similar to the UK Supreme Court, implemented a new, purportedly tighter test for a penalty, thus making it more difficult than ever before to avoid an agreed damages clause.[534]

Importantly, *Abbey National* illustrates that the most significant influence of the penalty rule on commercial activity may be the measures undertaken to escape its applicability.[535] In this regard, practical suggestions and alternative procedures which may help to 'contract out' or 'contract around' the penalty rule are also being marketed.[536] For instance, it has been suggested that when UK law, which currently applies the broader legitimate interest test established in *Cavendish*, is employed as the governing law in contracts, since primary obligations are not subject to the penalty regime, possibly penal provisions should be constructed as a conditional primary obligation (for example, a conditional, primary obligation to pay), rather than a remedy for breach of contract. It has been further suggested that critical elements of the contract wherein parties have a business interest should be highlighted and specifically mentioned, thereby making the eventual identification of a legitimate interest easier.[537]

Furthermore, typically, under the common law, courts have ruled that where parties had freely entered into a contract with equal negotiating power and the assistance of legal advice, the disputed clause would have a better probability of being sustained. Courts will ordinarily consider the underlying transaction's objective and the specific primary obligation which has been breached to have a comprehensive understanding of the contract and the character of the parties' relationship. It has therefore been also recommended that evidence and documentation on these factors should be kept because

[533] *Paciocco v Australia and New Zealand Banking Group* [2016] HCA 28, (2016) 333 ALR 569 [6].
[534] Halson and Liu (n 485).
[535] ibid
[536] Roger Halson, *Liquidated Damages and Penalty Clauses* (Oxford University Press 2018).
[537] Yong Kaichang, Edmund Wan and Cui Weiyi, 'An update on international legal positions – Liquidated damages' (5 February 2021) <www.kwm.com/en/cn/knowledge/insights/new-trend-of-international-legal-position-liquidated-damages-20210119> accessed 24 June 2022.

they may assist the court in reaching a determination that the provision should be enforced.[538]

3.3.2.3 Abolition of the Penalty Rule

A debate has been initiated for the abolishment of the penalty rule. To begin with, it has been bitterly remarked that the rule is 'a major unexplained puzzle in the economic theory of the common law'.[539] Further, one issue for determination in *Cavendish* was precisely whether the penalty rule should be repealed. Yet, the Supreme Court refused to eliminate it, opting to modify it instead.[540] It has been argued that the introduction of a broader 'legitimate interest' was aimed to rescue rather than abolish the *ex ante* evaluation incorporated in Lord Dunedin's tests in *Dunlop*. However, the Supreme Court's decision was critiqued for upholding an ambiguous 'legitimate interest' criterion which has reintroduced doubt into the law. It has been contended that, since it is highly improbable that the common law courts are motivated to rewrite contracts on a large scale, the Supreme Court in *Cavendish* should have abolished entirely the penalty rule rather than preserving it on the ground of an inappropriate contrasting study and permitting it to dwell in a legal and social environment adversarial to remedial justice advancement and versatility as an influential strategy.[541] It has also been argued that, given the Consumer Rights Act's wide control of unfair terms, the necessity to safeguard consumers through the penalty rule appears to be significantly diminished.[542]

Moreover, it has been contended that the justification for the penalty rule was never explained properly.[543] In *Cavendish*, Lords Neuberger and Sumption also intimated that

[538] ibid.
[539] Richard Posner, 'Some Uses and Abuses of Economics in Law' (1979) 46 University of Chicago Law Review 281, 290.
[540] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [36]-[39].
[541] Halson and Liu (n 485).
[542] Morgan (n 489).
[543] Halson and Liu (n 485).

there was no clear rationale when they questioned whether 'the courts would have invented the rule today if their predecessors had not done so three centuries ago'.[544] The primary traditional rationale for the penalty rule has been public policy.[545] It has been argued that the essence and purpose of such public policy have never been clearly stated, resulting in taxonomic discrepancies. First, in *Cavendish*, the Supreme Court refused to extend the penalty rule to an occurrence apart from breach of contract by the party in default and reconfirmed the penalty jurisdiction's customary boundary that such a breach must trigger the agreed damages. Hence, the penalty rule is inapplicable to situations where there is no breach of contract, for instance, where a fee is due pursuant to an upside fee agreement between a bank and a debtor.[546]

Secondly, it appears that the relevant public policy operates at the time the contract is made and requires an *ex ante* evaluation of the validity or enforceability of the relevant provision. However, it is debatable whether post-contractual evidence should be eliminated since it could be argued that the evaluation's acknowledged objective is the clause's punitive purpose and effect rather than the parties' aim to punish. Thirdly, the penalty rule's policy ambiguity is noticeable in its tense relationship with the UK's statutory regime which governs unfair contract terms. The notion that the penalty rule is still beneficial in a business setting appears unwarranted unless it can be proven that the penalty rule is based on a policy different from that of the statutory regime. Alternatively, it has been suggested that the most viable argument for such judicial involvement could be based on a public policy which supports remedial justice, recognizing that an agreed damages provision is a contractual arrangement of a secondary, rather than a primary, duty. Additionally, the conventional statement of the policy against punishment has been

[544] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [36].
[545] Andrew Burrows, *Remedies for Torts and Breach of Contract* (3rd edn, Oxford University Press 2004) 450–1.
[546] *Edgeworth Capital (Luxembourg) Sarl v Ramblas Investments BV* [2016] EWCA Civ 412; [2017] 1 All ER (Comm) 577 (CA).

contested given that control of agreed damages is intrinsically linked with remedial justice or adequacy.[547]

Notwithstanding the aforesaid, it is to be noted that 'the penalty rule originates in the concern of the courts to prevent exploitation in an age when credit was scarce and borrowers were particularly vulnerable'.[548] As argued in Chapter Two, in today's world, consumers are still vulnerable. In *Cavendish*, the Supreme Court itself rejected an argument that the penalty rule should be abolished because the UK has a statutory regime which governs unfair contract terms and is guided by a policy against unethical advantage-taking in contract negotiations, holding that such statutory regime was restricted in scope, excluding 'non-consumer contracts', such as those encompassing 'professionals and small businesses'.[549] It has been argued that the Supreme Court implied that the penalty rule is unnecessary in a consumer scenario, hence, hinting that its underlying principle is consistent with the legislative framework and confronts unethical advantage-taking.[550] However, as will be discussed in the next chapter, the UK's statutory regime has its limitations as well. It is, therefore, arguable that the penalty rule should subsist and be given significant consideration by courts when reviewing bank-customer contracts.

Hence, in view of all the aforesaid, it is arguable that the penalty rule as currently adopted provides inadequate protection to bank customers. This is the more so because it provides a narrow degree of *ex ante* protection. It puts focus on *ex ante* reasonableness.[551] In this regard, it has been suggested that, if common law intends to defend the penalty rule on the basis of relatively weak substantive fairness, it should strongly contemplate acknowledging an overall test of fairness for all contract terms

[547] Halson and Liu (n 485).
[548] *Cavendish Square Holding BV v Talal El Makdessi and ParkingEye Limited v Beavis* [2015] UKSC 67, [34].
[549] ibid [38], [167].
[550] ibid [115].
[551] Halson and Liu (n 485).

similar to that running parallel to the *weiyue jin* rule[552] under Chinese law. This is because the lone penalty rule has a serious difficulty defending a demarcation between agreed damages terms and other contract terms.[553]

Indeed, as previously mentioned, it has been argued that the broader 'legitimate interest' was adopted to retrieve the *ex ante* appraisal incorporated in Lord Dunedin's tests in *Dunlop* for the penalty rule.[554] In this context, it has been argued that the necessity for a breach of contract for the penalty rule to apply and the *ex ante* evaluation by reference to the moment of contracting are incompatible with any distinctly expressed justification for the authority to analyse agreed damages clauses. Further, as aforementioned, it appears that the relevant public policy is triggered at the moment the contract is entered into and demands an *ex ante* assessment of the relevant clause's validity or enforceability. The main judge's decision in *Paciocco* was overruled because she considered events which occurred after the contract was signed.[555]

3.4 Conclusion

This chapter contends that the common law of contract fails to adequately protect bank customers. As argued in Chapter Two, there is a need for an impure paternalistic approach. Yet, the common law of contract favours practically freedom of contract and does not take the paternalistic stance that it should take, as it is argued in Chapter Two. On the contrary, contract law commences from the notion that the bank-customer relationship is an arm's length relationship wherein both parties can prioritise their own interests and banks do not owe a general fiduciary duty to customers. The bank-customer relationship is fundamentally commercial, based on contract. Contract law acclaims the freedom of contract of both sides and, in principle, allows exclusion of liability and

[552] Chinese Contract Law, art 114.
[553] Halson and Liu (n 485).
[554] ibid.
[555] *Paciocco v Australia and New Zealand Banking Group* [2016] HCA 28, (2016) 333 ALR 569.

variation clauses to be inserted in contracts. Banks owe neither a general duty of care to customers nor a duty to advise unless specifically undertaken. Banks can contract out of their implied duty of confidentiality or are permitted to disclose information if they attain prior approval from customers.

The chapter also demonstrates that the common law of contract does not completely proclaim freedom of contract because it endorses two key common law rules – the doctrine of undue influence and the penalty rule – which indeed invade freedom of contract. The concept of undue influence provides that bank customers who were subjected to such influence may cast aside the contract. The penalty rule stipulates that penalty clauses are invalid and, therefore, any such clauses in a bank-customer contract are unenforceable. The chapter argues that these doctrines are, however, faulty and provide only a narrow degree of *ex ante* protection. The doctrine of undue influence basically applies in the tightly defined instances where bank customers furnish a security or guarantee for a spouse's or close relative's debt. Moreover, the doctrine essentially compels banks to ascertain that the customers who provide the security or guarantee have attained appropriate legal advice before they sign the contract. The penalty rule provides inadequate protection to bank customers for three major reasons. First, the UK Supreme Court recently effectively restricted the test for the penalty rule, making it harder for customers to avoid the contract's provision. Secondly, a penalty clause can be so well drafted as to be masked as a valid and enforceable default clause or liquidated/agreed damages clause. Thirdly, there has been an initiative to annihilate the penalty rule altogether.

Thus, in essence, the common law of contract fails to adequately provide bank customer protection because it really promotes freedom of contract and does not provide the kind of impure paternalism emphasised in Chapter Two. It only provides a restricted *ex ante* protection as a result of the doctrine of undue influence and penalty rule once the formalities of a contract are satisfied. It may be argued that courts provide *ex post* protection. In response, it is argued that courts are reluctant to interfere with bank

contracts and favour freedom of contract and party autonomy, as discussed in Chapters Five and Six. Therefore, the current chapter reinforces the overall argument of the thesis that a synthesis of private law and financial regulation is essential for a complete, coherent system of finance law that adequately protects bank customers.

Chapter Four

The Limitations of Bank Customer Protection in Statutory Consumer Law

4.1 Introduction

Private law concepts of contract, tort and equity have long coexisted with statute.[556] However, in contrast to several statutory regimes which enhance or supplement these traditional law concepts,[557] statutory consumer law ordinarily furnishes a novel stream of rights which, while being closely analogous to those provided in contract, tort and equity, function separately from such laws. Although consumer protection statutes run in tandem with the general law and resemble it in various aspects, the primary goals of the statutory regimes are essentially to promote consumer protection and fair market practices.[558]

The aim of this chapter is, in fact, to analyse to what extent two main consumer protection statutes, namely, the Consumer Rights Act 2015 (CRA 2015) and the Consumer Credit Act 1974 (CCA 1974), which was updated by the Consumer Credit Act 2006, do protect bank customers as consumers of banking services. It investigates whether these statutes commend freedom of contract or whether they furnish the impure paternalism recommended in Chapter Two.

[556] Mark Leeming, 'Theories and Principles Underlying the Development of the Common Law: The Statutory Elephant in the Room' (2013) 36(3) The University of New South Wales Law Journal 1002.
[557] eg Misrepresentation Act 1967.
[558] Elise Bant and Jeannie Marie Paterson, 'Consumer Redress Legislation: Simplifying or Subverting the Law of Contract' (2017) 80(5) Modern Law Review 895.

The chapter argues that these two statutes provide limited protection to consumers for three main reasons, the third reason flowing logically from the other two. First, some provisions, particularly the CRA 2015's unfair terms provisions and the CCA 1974's unfair relationships provisions, are lengthy, difficult to comprehend and unpredictable.[559] Secondly, while the CRA 2015's assessment criteria are comprehensive, taking cognisance of the contract's nature and surrounding circumstances, and have a broad scope as they apply to all kinds of consumer contracts, the protection simply evaluates whether the individual terms imposed were unfair. Moreover, the relevant CRA 2015 provisions are not applicable to the fairness of the contract's main terms or the price's appropriateness when these terms are transparent and prominent.[560] In contrast, the CCA 1974's unfair relationships sections empower a court to consider individual terms as well as how the bank has employed or enforced any right under the agreement or any associated agreement, or any other action taken or not taken, by the bank or on the bank's behalf.[561] Additionally, the relevant CCA 1974 requirements are applicable to the contract's essential terms. However, they are narrow in scope because they only apply to one sort of consumer contracts, namely credit agreements. Third, the CRA 2015 only provides a weak form of *ex post* protection post sale, after a consumer contract is signed, whereas the CCA 1974 provides consumers with some degree of *ex ante* protection, at the point-of-sale stage, and a vague form of *ex post* protection post sale, after the credit agreement is signed.[562]

[559] Emmanuel Sheppard, 'The court's discretion to determine unfair relationships: new guidance' (2019) 34(10) Journal of International Banking and Financial Law 680; Paul Skinner, 'Caveat creditor: difficulties in unfair relationship claims (2015) 30(9) Journal of International Banking and Financial Law 555.
[560] CRA 2015, s 64(1).
[561] CCA 1974, ss 140A-140D.
[562] Iris H-Y Chiu, Andreas Kokkinis and Andrea Miglionico, 'Addressing the challenges of post pandemic debt management in the consumer and SME sectors: a proposal for the roles of UK financial regulators' (2 October 2021) Journal of Banking Regulation <https://doi.org/10.1057/s41261-021-00180-2> accessed 18 February 2022.

4.2 The Consumer Rights Act 2015

The CRA 2015 is the most comprehensive and important reform of business to consumer (B2C) contract law.[563] Parts 1 and 2 by themselves integrate and modify B2C contract law rules which affect millions of B2C contracts every day.[564] Of relevance to consumers of banking services, they alter the Unfair Contract Terms Act 1977 (UCTA 1977) and the Supply of Goods and Services Act 1982 in respect of B2C contracts and repeal and substitute the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR 1999),[565] which implemented the European Union (EU) Unfair Terms in Contracts Directive (UTCCD).[566] The CRA 2015 is applicable to all consumer contract terms, whether individually negotiated or not, and to contracts ancillary to a main contract.[567] The CRA 2015 protects consumers because it furnishes them with rights and remedies in relation to banking contracts and unfair terms in such contracts. This part of the chapter discusses these rights and remedies and the extent of protection which the CRA 2015 provides to the consumer.

[563] Lorraine Conway, 'Consumer Rights Act 2015' (House of Commons Library Briefing Paper, No 6588, 17 May 2022) <https://researchbriefings.files.parliament.uk/documents/SN06588/SN06588.pdf> accessed 23 June 2022.
[564] Chris Willett, 'Re-Theorising Consumer Law' (2018) 77(1) Cambridge Law Journal 179.
[565] Conway (n 563).
[566] Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts [1993] OJ L95/29.
[567] CRA 2015, s 72.

4.2.1 Consumer contracts for banking services

4.2.1.1 Statutory rights

4.2.1.1.1 Service to be performed with reasonable skill and care

The first statutory right that the CRA 2015 provides to consumers is that banks must perform service contracts for consumers with reasonable skill and care.[568] It has been claimed that this negligence-based standard represents the self-interest/reliance ethic, permitting the bank to employ its 'inputs' and procedures to avoid accountability for low quality and harsh outcomes. A consumer must not only prove a defective outcome but must also demonstrate that the bank's procedures were not in accordance with standard banking practice, otherwise the bank is usually exempt from liability.[569] However, given their restricted knowledge and experience in such areas, and their weak bargaining skills and power from a need-based perspective, this entails a high level of consumer self-reliance.[570]

Another choice which the consumer has is to exert prior self-reliance and convince the bank to pre-contractually do either an explicit contractual commitment to attain a good outcome or a less formal one which could nevertheless direct a court to establish a common law implied factual term that the outcome will be reasonably up to standard.[571] However, due to their restricted knowledge, experience and negotiating power, from a need-based perspective, it is impossible that a consumer will manage to elicit such a commitment. If a consumer cannot prove a defect in the bank's procedures, economic harm will not be remedied. Consequently, it is arguable that the defect, or

[568] CRA 2015 s 49(1).
[569] *Bolam v Friern Hospital Management Committee* [1957] 2 All ER 118.
[570] Willett (n 564).
[571] *Independent Broadcasting Authority v EMI & BICC* (1980) 14 BLR 1.

input/procedure-based, standard of the duty to exercise reasonable skill and care affords minimal protection to the consumer in this regard.[572]

According to behavioural studies, consumers are less likely to depend on their legal rights due to anticipated costs and risks, which are exacerbated by complex and uncertain norms. Responding that a consumer would gain from the shifting of the burden of proof pursuant to the *res ipsa loquitur* doctrine, thereby the flawed outcome causing the court to deduce negligence in the bank's procedures, is beside the point.[573] The CRA 2015's specific policy objective is to simplify the law for the consumer to be capable of exerting their rights and receive redress outside court,[574] where the *res ipsa loquitur* doctrine is ineffective. The strategy to the services conformance norm, nonetheless, demonstrates the ethical tension which runs between consumer contract law and the implications for certainty, clarity and protection. In this case, the ethic is that of self-interest/reliance, resulting in erosion of certainty and clarity, and minimal protection to the consumer.[575]

4.2.1.1.2 Information about the bank or service to be binding

Furthermore, the CRA 2015 furnishes what has been depicted as a 'new, significant and complex provision'.[576] By creating novel statutory terms of contract, Section 50 essentially makes anything that a bank states or writes to a consumer as well as certain information which a bank provides to a consumer binding on the bank. Anything expressed or written to the consumer regarding the bank or service is deemed to be a

[572] Willett (n 564).
[573] ibid.
[574] Department for Business, Innovation and Skills (BIS), 'Enhancing Consumer Confidence by Clarifying Consumer Law: Consultation on the supply of goods, services and digital content (July 2012) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/31350/12-937-enhancing-consumer-consultation-supply-of-goods-services-digital.pdf> accessed 23 June 2022; BIS was replaced by the Department for Business, Energy and Industrial Strategy (BEIS) on 14 July 2016; see <www.gov.uk/government/organisations/department-for-business-energy-and-industrial-strategy> accessed 1 October 2022.
[575] Willett (n 564).
[576] Hugh Beale (ed), *Chitty on Contracts*, vol 2 (34th edn, Sweet & Maxwell 2021) para 38-532.

contract term if the consumer takes cognisance of it when making a decision to enter into the contract or on the service following the signature of the contract.[577] Notably, this comprises any advertising material or website which the consumer utilises in their determination to enter into the banking contract.[578] The assumption is subjected to any conditions which the bank communicates simultaneously to its consumer and/or any adjustments specifically agreed upon with the consumer.[579]

It has been submitted that, doubtlessly, the issue of whether a consumer takes cognisance of a specific statement is typically a hard factual enquiry. Notably, Section 50 makes no requirement that reliance must be reasonable. It has been argued that a consumer may erroneously rest on a bank's ludicrous statement and yet be protected under Section 50. It has been suggested that, given the lack of authority on Section 50, a consumer should be particularly cautious and mindful of any qualifications which the bank makes in the same communications with the representation.[580] These qualifications prohibit the consumer from arguing that the statement was considered.[581]

Section 50 aims to achieve what the then Department for Business, Innovation and Skills (BIS) explained in its consultation paper to be 'a statutory guarantee that a service will meet the description given pre-contractually'.[582] BIS expected such a statutory assurance to clarify the law and be more reachable by consumers and traders rather than changing the law's essence.[583] However, it has been argued that Section 50 does in fact amend the law's essence.[584] It may be simpler for consumers to convert anything stated or

[577] CRA 2015, s 50(1).
[578] CMS Law-Now, 'Financial Services and the Consumer Rights Act 2015' (2 October 2015) <www.cms-lawnow.com/ealerts/2015/10/financial-services-and-the-consumer-rights-act-2015> accessed 23 June 2022.
[579] CRA 2015 s 50(2).
[580] Jonathan Lewis, 'Section 50 of the Consumer Rights Act: should lenders be worried?' (2017) 32(8) Journal of International Banking and Financial Law 472.
[581] CMS Law-Now (n 578).
[582] BIS (n 574) para 6.83.
[583] ibid.
[584] Elizabeth Ovey, 'The Consumer Rights Act 2015: clarity and confidence for consumers and traders?' (2015) 30(8) Journal of International Banking and Financial Law 504.

written before the contract into an actionable representation because all they are required to demonstrate is a minimal level of reliance thereupon.[585] It has been further contended that, in the case of consumer contracts, Section 50 seems to eliminate the difference between contractual statements and misrepresentations. It has been claimed that nowadays representations are more likely to be included in contracts than before if banks do not pay attention to, simultaneously, properly qualify any statement made.[586]

In general, section 50 may benefit consumers by extending the number of statements included in contracts and providing extra remedies for these statements. However, it is disputable whether the law is actually made clearer and more reachable. It is hoped that a bank will be more easily convinced that it is liable under contract and will agree to furnish one of the novel remedies to satisfy the consumer's needs. It has been suggested that banks will now tend to make less unqualified statements, particularly vocally. Nevertheless, if the end result is merely that a bank explains more specifically the service it intends to deliver, this will be useful in and of itself.[587]

It is submitted that the adoption of Section 50 is unlikely to significantly affect banking business. Nonetheless, on one end, banks have been advised to ascertain that their employees are trained well and maintain thorough records of every communication with consumers, comprising adequately detailed internal notes of meetings with consumers. Banks may also restrict their liability by explicitly eliminating any written or verbal statements made, inserting clear provisions on the price and period for performance in the contract, and, if applicable, specifying any extra fees and total costs per billing period which consumers must pay. On the other end, it is suggested that consumers should be advised of their rights and remedies under the CRA 2015 and keep proof of all information, representations and 'sales talk' which they considered when deciding to enter into contracts with banks. The reason is that these may be beneficial in enforcing their

[585] Lewis (n 580).
[586] Ovey (n 584).
[587] ibid.

rights under the CRA 2015, which rights are now actionable in such a manner that previously, they were not, that is, now consumers enjoy the right to a price reduction.[588]

4.2.1.1.3 Other Statutory Rights

The CRA 2015 encompasses other protective provisions. It stipulates that when a consumer has not paid in advance for a service and the contract lacks an explicitly stated price or other consideration and an indication of how it should be established,[589] the contract must be regarded as encompassing a term indicating that the consumer must pay no more than a reasonable price for the service.[590] What constitutes such a price is a factual matter.[591] If the contract lacks an explicitly stipulated time for performance and an indication of how it should be determined,[592] the bank must supply the service within a reasonable time.[593] Such a period, like a reasonable price, is a factual issue.[594]

Further, the CRA 2015 provides that its Chapter Four service provisions have no effect on any legislation or rule of law which places a stronger duty on banks.[595] Instead, Chapter Four provisions are subjected to any other legislation which specifies or restricts the rights, duties or liabilities associated with any kind of service.[596] These provisions are especially relevant in regard to banking services, which have been increasingly regulated since the CCA 1974 was enacted. The latter established various remedies and measures to help consumers with loans that it oversees. Additionally, under Part 4A of the Consumer Protection from Unfair Trading Regulations 2008,[597] consumers may be entitled to a monetary compensation for false statements. Furthermore, pursuant to the

[588] Lewis (n 580).
[589] CRA 2015, s 51(1).
[590] CRA 2015, s 51(2).
[591] CRA 2015, s 51(3).
[592] CRA 2015, s 52(1).
[593] CRA 2015, s 52(2).
[594] CRA 2015, s 52(3).
[595] CRA 2015, s 53(1).
[596] CRA 2015, s 53(2).
[597] SI 2008/1277.

Financial Services and Markets Act 2000 and regulations issued thereunder, and the FCA's handbook, the Financial Conduct Authority (FCA) regulates banks very strictly. Nevertheless, the CRA 2015 itself also assists consumers as it may be applicable in situations where banking contracts are not generally controlled and furnishes a novel remedy in the form of a decrease in price.[598]

4.2.2 Unfair Terms Regime

Part 2 of the CRA comprises the unfair contract terms regime. It consolidates the formerly overlapping provisions of the UCTA 1977 and UTCCR 1999.[599] The novel framework includes additional safeguards, essentially, individually negotiated terms are subject to the unfairness test[600] and, despite the parties have not raised the matter themselves, courts must nonetheless consider a term's fairness provided they have the necessary factual and legal evidence.[601]

The unfair terms regime has had a significant impact on consumer banking and finance contracts. Exclusion of liability clauses, indexation clauses, interest rate clauses, default interest clauses, default charges clauses and clauses regarding power to call in loans, modify financial products' terms or characteristics, terminate contracts or vary interest rates or charges, are examples of pivotal terms, used commonly in banking and finance contracts, which could be impacted. The unfair terms regime's effects are the result of a combination of judicial action by regulators and consumers, and the industry's defensive efforts to arrange terms and conditions in consumer contracts such that they are more defensible to challenge.[602]

[598] Lewis (n 580).
[599] Willett (n 564).
[600] CRA 2015, s 62.
[601] CRA 2015, s 71.
[602] Mark Fell, 'Unfair terms regulation: the mandatory statutory or regulatory provisions exception' (2018) 33(2) Journal of International Banking and Financial Law 74.

4.2.2.1 Unfair Contract Terms and Notices are not Binding

Unfair terms are nonbinding on consumers.[603] A term is unfair when, contradictory to the good faith requirement, it generates a significant imbalance in the parties' rights and duties, which stem from the contract, to the consumer's detriment.[604]

4.2.2.1.1 The Notion of Good Faith

In *Yam Seng Pte Ltd v International Trade Corporation Ltd*,[605] the court determined that the concept of good faith necessitates parties to act honestly for commercial transactions to be effective. The test of good faith is objective because it depends on whether the behaviour would be viewed as commercially unacceptable by reasonable and honest individual in the specific circumstances rather than on the parties' view of whether the behaviour is inappropriate. Good faith entails a high level of communication, collaboration and predictable performance, built on a foundation of mutual trust and confidence, as well as loyalty expectations.[606]

It has been highlighted that the interaction and distinction between reasonableness and good faith are subtle but significant, and that satisfying a norm of reasonable conduct is more onerous than satisfying the good faith criterion.[607] In this respect, it is less consumer protective. Good faith, on the other hand, is a demand of conscience.[608] It has been further acknowledged that reasonable conduct necessitates operating in good faith. Dishonesty, deliberate contradiction and exploitation are invariably unreasonable. It has

[603] CRA 2015, ss 62(1) and (2).
[604] CRA 2015, ss 62(4) and (6).
[605] *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB), [2013] 1 All ER (Comm) 1321.
[606] ibid; Gerard McMeel, 'Foucault's Pendulum: Text, Context and Good Faith in Contract Law' Current Legal Problems (2017) 70 (1) Current Legal Problems 365.
[607]Jane Stapleton, 'Good Faith in Private Law' (1999) 52 Current Legal Problems 1, 8.
[608] *SNCB Holding v UBS AG* [2012] EWHC 2044 (Comm).

also been pointed out that operating in good faith is nonetheless insufficient to meet a reasonableness norm. As many unintentional negligence lawsuits demonstrate, an individual may operate in good faith yet act unreasonably as determined by an objective norm.[609]

In *Director General of Fair Trading v First National Bank plc* (*First National Bank*),[610] the House of Lords concluded that good faith incorporates a generic notion of 'fair and open dealing'.[611] In order to determine whether the bank acted in good faith, the court must examine whether the bank exploited the consumer as well as whether the court could reasonably presume that, had the bank dealt with the consumer fairly and equitably, the latter would have consented to the provision if the contract was bargained on equal footing.[612] When drafting contract provisions, the bank must both withstand the urge to exploit the consumer and to actively consider the consumer's legitimate interests.[613]

4.2.2.1.2 Significant imbalance

Additionally, a provision must cause a significant imbalance in the parties' rights and duties to the consumer's detriment for it to be considered unfair.[614] It has been claimed that there is a problem with what is meant by 'significant imbalance'.[615] Undeniably, significant imbalance essentially encompasses the matter of substantive unfairness.[616] In *First National Bank*, the House of Lords affirmed that the parties should be permitted

[609] Stapleton (n 607) 8.
[610] *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2001] AC 481.
[611] ibid [17].
[612] see Case C-415/11 *Aziz v Caixa d'Estalvis de Catalunya, Tarragona i Manresa (Catalunyacaixa*) [2013] ECLI:EU:C:2013:164.
[613] Competition and Markets Authority (CMA), 'Unfair contract terms guidance: Guidance on the unfair terms provisions in the Consumer Rights Act 2015' (31 July 2015) para 2.24 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/450440/Unfair_Terms_Main_Guidance.pdf> accessed 23 June 2022.
[614] CRA 2015, ss 62(4) and (6).
[615] Chris Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (2012) 71(2) The Cambridge Law Journal 412.
[616] *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52, [2001] AC 481, [17].

to rest on their contract's terms unless the interest due pursuant to the contract created an imbalance in the parties' rights and duties. Their Lordships also stated that a significant imbalance exists when the relevant provision favours the bank 'significantly', whether by according it a 'beneficial option, discretion or power' or inflicting 'a disadvantageous burden, risk or duty' on the consumer.[617] It has been commented that this just lists the provisions which the test covers and nothing else.[618] It is claimed that a consumer banking contract is balanced when the parties have equal rights in practice, especially given the type of services furnished pursuant to the contract. The mere establishment of a formal or mechanical equality of rights and duties is insufficient to avoid a significant imbalance.[619]

Surprisingly, the CRA 2015 does not prohibit a provision, in security documents, which excludes a consumer's right of set-off, but its validity may be questioned.[620] In *Stewart Gill Limited v Horatio Myer & Co Limited*,[621] an extremely broad exclusion clause was victoriously contested under the UCTA 1977. The underpinning rationale seems to be that the secured bank should be permitted to have the protection of the security for which it has bargained and should not be stripped of that protection by a pure monetary claim *a fortiori* if such claim is not liquidated.[622]

4.2.2.2 The Core Terms Exemption

The fact that a contract's basic terms cannot be contested[623] is a severe limitation on the CRA 2015's reach and, consequently, a setback to consumer protection. The CRA 2015

[617] ibid.
[618] Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (n 615).
[619] CMA (n 613) paras 2.13–2.15.
[620] Elizabeth Ovey, 'Secured indebtedness, set-off and enforcement: the law after Woodeson v Credit Suisse' (2019) 34(2) Journal of International Banking and Financial Law 85.
[621] [1992] 1 QB 600.
[622] Ovey, 'Secured indebtedness, set-off and enforcement: the law after Woodeson v Credit Suisse' (n 620); see *Woodeson v Credit Suisse (UK) Ltd* [2018] EWCA Civ 1101.
[623] CRA 2015 s 64(1).

provisions cover terms regarding default notifications and related costs because they are ancillary terms.[624] Notably, the exemption is not absolute. The main subject matter and price are excluded from fairness evaluation solely when the term is transparent and prominent.[625] A comprehension of the CRA 2015's methodology for determining which charges constitute the price requires a consideration of how the term 'price' was construed under the UTCCR 1999 framework prior to the CRA 2015.[626] Indeed, the term 'price' was given a very broad connotation.[627] Thus, in *Paragon Finance plc v Nash*,[628] the mortgage loan contract provided that interest would be charged at the rate that the company would apply periodically to the type of business which it considered the mortgage belonged to, and that this rate could, therefore, be increased or decreased at any time. The court inferred an implied term stipulating that the interest rate would not be established in an arbitrary, capricious or dishonest manner, as well as for an inappropriate reason.[629]

The main judgment is *Abbey National*,[630] which involved provisions that allowed banks to impose significant charges if consumers surpassed agreed-upon overdraft limits. The clauses did not refer to exceeding the overdraft limits as a default or breach but rather as the customer choosing to use a service. Hence, the charge was classified as a fee for the bank's service, that is, the service to enable the payment to be effected out of the account, rather than as reimbursement for the bank's loss.[631] The Court of Appeal retained that the 'price' merely captured fees which a normal consumer would deem 'essential' to the agreement, excluding fees for unauthorised overdrafts that the consumer would not have intended to use at the time the contract was signed. Given that the

[624] Gerald Swaby, Rebecca Kelly and Paul Richards, 'Bill of Sale Lending: Reforming a "Toxic" Form of Credit' (2018) 81(2) Modern Law Review 308.
[625] CRA 2015 s 64(2).
[626] Willett, 'Re-Theorising Consumer Law' (n 564).
[627] Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (n 615).
[628] [2001] EWCA Civ. 1466.
[629] Dennis Rosenthal, 'The scope of a mortgagee's implied rights' (2020) 35(2) Journal of International Banking and Financial Law 124.
[630] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.
[631] Willett, 'Re-Theorising Consumer Law' (n 564).

charges were not included in the 'price', these charges' substantive fairness could be determined by means of the unfairness test.[632]

The Supreme Court rejected the Court of Appeal's ruling, refusing to differentiate between main and other fees and asserting that the court's determination of the 'price' is based on an 'objective interpretation'.[633] The Supreme Court used a wider definition of the contract's subject matter.[634] It held that the charges at issue were not default fees, although acknowledging that the charges resulting from the consumer's default did constitute the 'price'. Instead, the Supreme Court endorsed the terms' description of the circumstances, essentially, that the charges were due for services. It also affirmed that these charges qualified as the 'price', even though they were not ordinary contractual fees but rather based on subsequent consumers' actions or inactions. Basically, the Supreme Court ruled that a contract provision requiring charges to be paid for unauthorised overdrafts on personal bank accounts qualified under the exemption. Hence, they cannot be subjected to the fairness test. The Supreme Court held that twelve million UK individuals were routinely being subjected to such fees.

This judgment was, correctly, heavily criticised. According to the Explanatory Note to the Irish Consumer Rights Bill 2015, the *Abbey National* decision did not reconcile with consumers' realistic expectations.[635] The Law Commissions stated that it 'proved difficult to interpret, with regulators and business expressing different views'.[636] Indeed, the Court of Justice of European Union (CJEU) interpreted the UTCCD more broadly. Thus, in

[632] *Abbey National plc v Office of Fair Trading* [2009] EWCA Civ 116.
[633] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696, [113].
[634] Yeşim M Atamer, 'Why Judicial Control of Price Terms in Consumer Contracts Might Not Always Be the Right Answer – Insights from Behavioural Law and Economics' (2017) 80(4) Modern Law Review 624.
[635] Department of Jobs, Enterprise and Innovation, 'Scheme of Consumer Rights Bill' (May 2015) 141 <https://enterprise.gov.ie/en/Consultations/Consultations-files/Scheme-of-a-proposed-Consumer-Rights-Bill-May-2015.pdf> accessed 23 June 2022.
[636] Law Commission and Scottish Law Commission, 'Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills' (March 2013) para S.8 <https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/06/unfair_terms_in_consumer_contracts_advice.pdf> accessed 23 June 2022.

Matei v SC Volksbank Romania SC,[637] the CJEU determined that the contract provisions which came under the contract's main subject matter must be considered to be those which establish the contract's key duties and represent it as such.[638] This appears to be a more restrictive view of the exemption than the one set forth in *Abbey National*.[639] It has been claimed that there is a considerable chance that the *Abbey National* judgment would be adopted, which is why Section 64 of the CRA 2015 was enacted.[640]

Section 64 has divided opinion. It has been argued that it is ambiguous and involves challenging legal interpretation issues about which prominent judges differed.[641] It has also been contended that there will, unavoidably, be disagreements over the scope of the contract's main subject matter. Banks should not be able to expand the main subject matter by describing the facility.[642] Contrastingly, it has been argued that this section provides more clarification as well as huge opportunities and challenges for banks.[643]

This wide attitude to price exemption is a further indication that the self-interest/reliance ethic mentioned earlier has an impact on the CRA 2015. It allows the bank to inflict high unessential fees, which are not subject to any substantive fairness evaluation, if the charges are described in such a way that the court accepts them as being for a service and are presented transparently and prominently. A consumer is highly expected to be self-reliant in these circumstances. On the other hand, a consumer's capability to perform any form of self-reliant act is constrained from a need-based standpoint. Surely, the

[637] Case C-143/13 *Matei v SC Volksbank Romania SA* [2015] ECLI:EU:C:2015:127.
[638] ibid [54]; see also Case C-26/13 *Kásler v OTP Jelzálogbank Zrt* [2014] ECLI:EU:C:2014:282.
[639] A diverse stance was taken by the German Federal Supreme Court (*Bundesgerichtshof*, BGH). The BGH determined that a management fee levied by banks following the conclusion of a consumer credit contract would not come within this exemption and could be regulated. The BGH found that the fee was unfair. See BGH, 13.05.2014 – XI ZR 405/12, (2014) Neue Juristische Wochenschrift (NJW) 2420; BGH, 28.10.2014 – XI ZR 348/13, (2014) NJW, 3713.
[640] Cliona Kelly, 'Consumer reform in Ireland and UK: Regulatory divergence before, after and without Brexit' (2018) 47(1) Common Law World Review 53.
[641] Richard Mawrey, 'Adversary or inquisitor? Judicial intervention in consumer banking litigation' (2016) 31(8) Journal of International Banking and Financial Law 466.
[642] Ross Cranston and others, *Principles of Banking Law* (3rd edn, Oxford University Press 2017) 210.
[643] Ovey, 'The Consumer Rights Act 2015: clarity and confidence for consumers and traders?' (n 584).

'prominence' and 'transparency' requirements are meant to assist a consumer take a more informed decision.[644]

However, the need-based perspective holds that all this will have little impact. A consumer is unlikely to read standard provisions, hence making them prominent and transparent, will not affect them much.[645] Consequently, the consumer is unlikely to be compelled to negotiate for cheaper fees – even if they tried, they are unlikely to succeed because they lack the necessary negotiation skills and power – or compare diverse bank charges. This results in the charges being frequently susceptible to very little competitive control.[646] Hence, the fact that unessential, particularly conditional, fees are exempted from the unfairness test is expected to lead to substantial consumer harm from a need-based viewpoint. Therefore, the CRA 2015 provides a small degree of consumer protection in respect of the price provision issue through this perspective. [647]

4.2.2.2.1 The Requirement of Transparency

It has been contended that the CJEU's understanding of the transparency obligation in Section 68, which understanding has been accepted by the Competition and Markets Authority (CMA), poses problems.[648] It has been claimed that it is inconsistent with the meticulous detailed management of unilateral variation and price-establishing clauses included in the statute's Grey List,[649] which implements the UTCCD's Annex. Strikingly, in regard to variation terms, the CJEU considered the UTCCD to embody a broad transparency criterion, essentially, that the consumer must be capable of foreseeing the

[644] Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (n 615).
[645] ibid.
[646] Willett, 'Re-Theorising Consumer Law' (n 564).
[647] Willett, 'General Clauses and the Competing Ethics of European Consumer Law in the UK' (n 615).
[648] Kelly (n 640).
[649] Malcolm Waters, 'The requirement of transparency under the Directive on unfair terms in consumer contracts: some problems' (2017) 32(11) Journal of International Banking and Financial Law 697.

amendments which may be performed based on clear, intelligible factors.[650] Likewise, the CMA stated in its guidelines on the CRA's unfair terms provisions that, in order for the transparency requirement to be met, clauses should be designed in a manner which assist the consumer to take an informed decision on whether to enter into the contract or not.[651] This keeps unanswered the issue of how precise the consumer must be in foreseeing the contract's repercussions.[652] It seems that in *Andriciuc v Banca Romanească SA*,[653] the CJEU upheld the Advocate General's argument that the transparency requirement signifies that the bank must provide the consumer such information which objectively is or should be within their knowledge when the contract is executed.

It has been argued that the CJEU's discernment of the transparency requirement caused considerable doubt on the fairness of variation clauses in agreements relating to the provision of banking services to consumers.[654] In this respect, the FCA's relevant guidelines highlight the pertinent clauses contained in the Grey List. Given the CJEU's case law, the FCA, prudently, does not view the Grey List's clauses to be explicitly recommending alternative paths for attaining fairness in variation clauses but, rather, gathers a larger variety of characteristics that it deems pertinent.[655] It has been contended that, however, it is debatable whether some features of the FCA's guidelines are congruent with the CJEU's transparency criterion.[656]

[650] Case C-92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen eV* [2013] ECLI:EU:C:2013:180.
[651] CMA (n 613) para 2.46.
[652] Waters (n 649).
[653] Case C-186/16 *Andriciuc v Banca Românească SA* [2017] ECLI:EU:C:2017:703.
[654] Malcolm Waters, 'New Guidance from the FCA on the fairness of variation terms in consumer contracts' (2019) 34(3) Journal of International Banking and Financial Law 170.
[655] FCA, 'Finalised guidance FG18/7: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015 (19 December 2018) para 40 <www.fca.org.uk/publication/finalised-guidance/fg18-07.pdf> accessed 23 June 2022.
[656] Waters, 'New Guidance from the FCA on the fairness of variation terms in consumer contracts' (n 654).

4.2.2.2.2 The Requirement of Prominence

The prominence requirement is contentious too.[657] The Law Commissions explained that a clause would be exempt if it is communicated to the consumer in a manner that, although they do not read the entire contract, a reasonable/average consumer would nevertheless be conscious of the clause.[658] Furthermore, the CMA believes that a prominence criterion is wholly compatible with a core exemption construction that solely the primary duties or price clauses susceptible to the competition's corrective forces and genuine decision-taking are entirely admissible for fairness.[659] It has been argued that the prominence criterion impedes clarity by rendering disputes less foreseeable.[660]

4.2.2.3 Duty of court to consider fairness of a term

A critical provision which should furnish significant consumer protection is the CRA 2015's Section 71. It sets a novel duty on the court to evaluate contractual provisions' fairness in consumer proceedings of its own motion. The demand for such a responsibility is justifiable since the consumer is in a poor bargaining situation with the bank in terms of both bargaining power and knowledge, causing them to agree to clauses, which the bank writes beforehand, without being capable of altering the contents of such clauses.[661]

It has also been contended that the court's novel responsibility is one intended for an inquisitorial judicial process which is being imposed on the English adversarial process without any consideration for its practical implications. It not only places a completely

[657] Ovey, 'The Consumer Rights Act 2015: clarity and confidence for consumers and traders?' (n 584).
[658] Law Commission and Scottish Law Commission, 'Unfair Terms in Consumer Contracts: a new approach? Issues Paper' (25 July 2012) paras 8.26–8.33 <https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jsxou24uy7q/uploads/2015/06/unfair_terms_in_consumer_contracts_issues.pdf> accessed 23 June 2022; see *Interfoto Picture Library Ltd v Stiletto Visual Programmes Ltd* [1989] 1 QB 433.
[659] CMA (n 613) para 3.7.
[660] Willett, 'Re-Theorising Consumer Law' (n 564).
[661] Case C-377/14 *Radlinger v Finway as* [2016] ECLI:EU:C:2016:283.

irrational burden on the judges, but it is abundantly dangerous. It has been argued that, for instance, with time, a clause on the Grey List, which is only a suggestive list of clauses which may be deemed unfair, will be assumed to be unfair unless extraordinary instances exist, which, in many situations, will not. Moreover, the juridical impact is questionable. It is debatable whether an appellate court, when confronted with an appeal concerning wholly diverse matters, should advance unfairness of terms of its own motion at such a late moment.[662]

4.2.2.4 The mandatory statutory or regulatory provisions exception

Another exception to the unfair terms' regime exists, which, therefore, further diminishes consumer protection. Pursuant to section 73, the contractual clauses that represent mandatory statutory or regulatory provisions are exempt from the CRA 2015's Part 2 provisions. This section largely implements Article 1(2) of the UTCCD. In *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen eV* (*RWE Vertrieb*),[663] the key case on this exception, the CJEU observed that Recital 13 of the UTCCD incorporates the primary reason for the exception. Recital 13 clarifies that unfair terms are deemed to be absent from statutory or regulatory clauses that directly or indirectly dictate the substance of consumer contracts. It is reasonable to assume that national legislators achieve a suitable balance between contracting parties' rights and duties.[664] In *Kušionová v SMART Capital as* (*Smart Capital*),[665] the CJEU emphasised that the argument in *RWE Vertrieb* has the consequence that the exception necessitates two elements to be met, namely, the contractual clause must represent a statutory or regulatory provision and such provision must be mandatory.[666] Further, given that it is a detraction from consumer protection law, it must be interpreted strictly.[667]

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[662] Richard Mawrey (n 641).
[663] Case C-92/11 *RWE Vertrieb AG v Verbraucherzentrale Nordrhein-Westfalen eV* [2013] ECLI:EU:C:2013:180.
[664] Fell (n 602).
[665] Case C-34/13 *Kušionová v SMART Capital as* [2014] ECLI:EU:C:2014:2189.
[666] ibid [78].
[667] Fell (n 602).

The CRA 2015 grants courts the authority to assess the fairness of any secondary contractual clause which was not individually negotiated, on the ground of a 'significant imbalance' criterion.[668] However, essential clauses, for instance, the ones concerning the product's price, are removed from the fairness analysis. Consumers are prohibited from challenging essential clauses, which unavoidably impact their welfare and outcomes,[669] because English courts have construed the essential terms' concept extensively, provided that consideration factors are present. As highlighted earlier, the Supreme Court concluded that charges for unauthorised overdrafts are an important component of the compensation which banks receive for providing a variety of current account services, hence, they are exempt from the fairness test.[670] This decision exemplifies the English courts' opposition to broad judicial intervention in private contracts.[671]

It is arguable that Part 2 the CRA 2015, like its predecessors, is not fully forthright. The core exemption is a significant impediment. It is debatable whether the courts' intervention through the review of unfair terms is the right method to solve the difficulty or, more obtrusively, whether the difficulty has been fixed at all following these judgments. Consumers have yet no idea what charges can be levied or how long-term contract prices can be amended. Legal certainty is lacking.[672] Merely considering the difficulty as one of unfair contract clauses does not give credit to the situation. Consumers cannot be further assisted under the CRA 2015 once a price clause is excluded from judicial scrutiny in accordance with section 64.[673]

It is further arguable that judicial control is and will continue to be a vital tool in the fight against unfair terms. However, by using the insights of behavioural law and economics, the UK legislator could interfere in a more precise and effective manner. It is suggested

[668] CRA 2015, s 62(6).
[669] Chiu, Kokkinis and Miglionico (n 562).
[670] *Office of Fair Trading v Abbey National plc* [2009] UKSC 6, [2010] 1 AC 696.
[671] Chiu, Kokkinis and Miglionico (n 562).
[672] Mawrey (n 641).
[673] Atamer (n 634).

that, since banks consistently employ behavioural sciences' findings to improve their devious pricing strategies, regulators should too incorporate these scientific insights to rectify behavioural market failures through more bespoke regulatory options. In the UK, a comprehensive attitude to similar difficulties is still lacking and the matter is frequently hidden behind a discourse about unfair terms control, which serves no role in terms of discovering a long-term remedy. Given the lack of *ex post* judicial oversight of pricing methods, policy interventions could help counteract consumer biases which are exploited by these pricing methods. *Ex ante* regulation targeted at interfering with misleading pricing approaches through stimulation of competition appears to be a preferable option. If consumers are unable to achieve this, the regulator must assess whether specific pricing forms should be prohibited. Given the enormous magnitude of contracts, this is very critical.[674]

Indeed, the possibility of regulatory action as to certain pricing clauses employed in many contracts should be investigated further. This is consistent with the separation of powers doctrine. Regulatory action could be developed on a tailored basis having regard to behavioural sciences' discoveries. Since one main difficulty concerning price clauses is that they are not susceptible to market forces, regulation should attempt to address this. The requirement for judicial oversight would be reduced if consumers are made more aware of particular pricing methods. If behavioural sciences' findings indicate that such awareness is difficult to create, legislators should consider meddling directly in such pricing methods.[675]

All this illustrates that the CRA 2015 furnishes a comparatively weaker form of consumer protection in the post-sale period following the conclusion of contracts.[676] Consumers of banking services are provided with a narrow degree of ex post protection, primarily, because the main contract terms and price terms in their banking contracts cannot be

[674] ibid 627.
[675] ibid.
[676] Chiu, Kokkinis and Miglionico (n 562).

reviewed. Hence, they are at the mercy of banks in the event that their personal circumstances change following a life-changing event.

4.3 The Consumer Credit Act 1974

The CCA 1974, and comprehensive secondary regulation issued thereunder, govern consumer credit supply in the UK.[677] Sections of the EU Directive 2008/48/EC on credit agreements (Consumer Credit Directive)[678] and EU Directive 2011/90/EU on annual percentage rate of charge assumptions[679] are implemented in various CCA 1974 provisions and related regulations, mainly the Consumer Credit (EU Directive) Regulations 2010. From 1 April 2014, the FCA became responsible for consumer credit regulation instead of the Office of Fair Trading (OFT).[680] Most CCA 1974 sections were maintained, some were substituted by FCA rules and others, such as the Regulated Activities Order,[681] were absorbed into the Financial Services and Markets Act 2000 (FSMA 2000) regime.[682] Certain CCA 1974 provisions, for instance, section 126 relating to enforcement of land mortgages, apply to regulated mortgages that are ordinarily governed by the FCA's Mortgages and Home Finance: Conduct of Business sourcebook (MCOB). Additionally, although loans are nowadays regulated mortgage contracts,

[677] Sarah Brown, 'Protection of the Small Business as a Credit Consumer: Paying Lip Service to Protection of the Vulnerable or Providing a Real Service to the Struggling Entrepreneur?' (2012) 41(1) Common Law World Review 59.
[678] Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC [2008] OJ L133/66.
[679] Commission Directive 2011/90/EU of 14 November 2011 amending Part II of Annex 1 to Directive 2008/48/EC of the European Parliament and of the Council providing additional assumptions for the calculation of the annual percentage rate of charge [2011] OJ L296/35.
[680] FCA, 'FCA takes over regulation of consumer credit firms - research shows 9m people are in serious debt and 1.8m in denial' (1April 2014) <www.fca.org.uk/news/press-releases/fca-takes-over-regulation-consumer-credit-firms-research-shows-9m-people-are> accessed 23 June 2022.
[681] Financial Services and Markets Act 2000 (Regulated Activities) Order 2001, SI 2001/544.
[682] FCA, 'Review of retained provisions of the Consumer Credit Act: Final report' (March 2019) para 2.29 <www.fca.org.uk/publication/corporate/review-of-retained-provisions-of-the-consumer-credit-act-final-report.pdf> accessed 23 June 2022.

certain CCA 1974 provisions remain applicable to second charge mortgages concluded prior to 21 March 2016.[683]

The CCA 1974 and associated regulations provide consumers with substantive rights and protections which complement the FSMA requirements.[684] It is impossible and beyond this section's scope to replicate all the CCA 1974's relevant provisions. Hence, it explains certain important rights and protections provided and some of the difficulties raised thereupon. Thereafter, it focuses on the unfair relationship provisions, which are critical for consumer protection. The CCA 1974 provisions are divided into three inter-related topics in this discussion: those providing directly rights and protections to consumers, those involving information obligations and those concerning sanctions, including unenforceability. This is essentially the approach taken by the FCA in its CCA 1974's review.[685]

4.3.1 Direct Rights and Protections

The CCA 1974 contains provisions which give consumers direct crucial rights and/or protections in connection with credit arrangements. Many provisions are intertwined with the bank's duties.[686] They generally track the consumer's journey.[687] Thus, certain provisions furnish rights to the consumer before they sign the contract. These provisions ordinarily deal with potential agreements, multiple agreements and prior discussions. Some provisions grant rights while the agreement is in effect. Such provisions typically cover variation of agreements, interest, enforcement notices, restrictions on default remedies, security, unauthorised payments and credit-tokens. Other provisions furnish rights to protect the consumer when the credit agreement is terminated. These provisions

[683] ibid para 1.14.
[684] ibid para 4.1.
[685] ibid para 3.7.
[686] ibid para 5.1.
[687] ibid para 5.4.

regard withdrawal, cancellation, early repayment and agreement termination. Certain provisions allow the consumer to act, for instance, section 66A confers the right to withdraw from a credit agreement. Other provisions are applicable axiomatically without the necessity for the consumer to act, for instance, section 82(1) prevents a bank from unilaterally varying an arrangement until the consumer is noticed in the prescribed way.[688]

Although diverse from the rights and protections provided by the CCA 1974, civil remedies available to the consumer under other consumer protection laws have been claimed to be commensurate and satisfactory to offer adequate consumer protection. Redress through the Financial Ombudsman Service (FOS); redress pursuant to the Consumer Protection from Unfair Trading Regulations 2008 (CPUTR 2008) through the courts; challenge of unfair contract terms under the CRA 2015; a private right of action under section 138D FSMA 2000; and courts' wide powers are among the civil remedies available.[689] On the other hand, it has been counter argued that such remedies are not equivalent to the rights and protections afforded by the CCA 1974 and furnish a different level of consumer protection.[690]

Despite having extensive authority to reward compensation for financial losses, other losses or damages, the FOS is unable to furnish the same degree of redress as the courts pursuant to the CCA 1974 and cannot nullify an agreement. Contrary to CCA 1974 protections, which are applicable automatically and may be employed as a defence in court, the FOS's protection is contingent on the consumer's willingness and ability to file a complaint.[691]

Pursuant to the CPUTR 2008, a consumer can sue a bank in the civil courts if the bank engages in aggressive or misleading practice. A complaint's evaluation is founded on the

[688] ibid para 5.2.
[689] ibid para 5.15.
[690] ibid para 5.16.
[691] ibid para 5.17.

manner such commercial practice would have impacted an 'average consumer' and not on the manner it could have harmed the specific consumer. Notwithstanding that the 'average consumer' criterion may be modified when a practice is targeted at a specific group, or when a practice significantly influences the economic conduct of a clearly distinguishable category of vulnerable consumers, the criterion restricts the extent of subjectivity. Additionally, a consumer must be capable of proving that the aggressive or misleading practice caused them to execute a payment or conclude a contract to be eligible for a civil remedy. Moreover, a right of redress is unavailable for payments made or contracts entered into prior to October 2014.[692]

The CRA 2015 provisions do not apply to the fairness of terms on the contract's main subject matter or the price's adequacy where such terms are transparent and prominent and/or are not within the Grey List. Despite the CRA 2015's evaluation criteria are broad, considering the contract' s nature and accompanying circumstances, the protection simply evaluates whether the inflicted individual terms were unfair. Contrastingly, the CCA 1974's unfair relationships regime permits a court to consider individual terms as well as how the bank has exerted or enforced any right under the agreement or an associated agreement, or anything carried out or not carried out by the bank or on its behalf.[693]

In a claim made pursuant to section 138D of FSMA 2000, the amount of damages for loss is likely to be different from that of the court's far-reaching powers as per section 127 of the CCA 1974. This encompasses the authority to diminish the consumer's liability,[694] issue a time order that reschedules payments[695] or subsequently amend the agreement's terms.[696] Moreover, the consumer may apply to reopen the agreement under the unfair relationships provisions in proceedings concerning the agreement's enforcement. The

[692] ibid para 5.19.
[693] ibid para 5.18.
[694] CCA 1974, s 127(2).
[695] ibid s 129.
[696] ibid s 136.

consumer must demonstrate that violation of the relative rule caused loss to the consumer.[697] In reality, a consumer is unlikely to institute proceedings under section 138D unless they are financially capable to undertake possibly expensive litigation where substantial losses have resulted.[698]

It has been submitted that some of these provisions are problematic.[699] It has been argued that, despite court rulings,[700] the provisions regarding multiple agreements create complexity and uncertainty. For instance, section 18's reference to 'category of agreement' is unclear and can lead to conflicting meanings.[701] Furthermore, no provision specifies when a contemplated agreement converts into a prospective one.[702] It has also been contended that having different withdrawal[703] and cancellation[704] regimes results in confusion for both the bank and consumer.[705] For instance, disparities exist in the cooling-off periods[706] and how rights are exercised.[707] Moreover, there are variances in the outcomes of the exercise of the rights, such as the ramifications for ancillary service contracts or related transactions.[708]

4.3.2 Information Requirements

The CCA 1974 encompasses provisions which oblige the bank to furnish pre-contractual,

[697] ibid para 5.20; FSMA s 138D(2).
[698] FCA (n 682) para 5.21.
[699] ibid para 5.1, 5.22.
[700] Eg *Southern Pacific Mortgage Limited v Heath* [2009] EWCA Civ 1135.
[701] FCA (n 682) Annex 5 para 37.
[702] ibid Annex 5 para 11.
[703] CCA 1974, s 66A.
[704] CCA 1974, s 67.
[705] FCA (n 682) para 5.40.
[706] CCA 1974, s 66A(2) provides that a consumer may withdraw from a credit agreement within fourteen days of the relevant day, typically when the agreement is made; s 68 provides that a consumer may cancel an agreement within five days of the receipt of a copy of the signed agreement or notice of cancellation rights, when required, or within fourteen days of signature of the agreement in other cases.
[707] CCA 1974, s 66A(2) states that a consumer may withdraw from a credit agreement either orally or in writing; s 68 states that a consumer states that a consumer may cancel an agreement only in writing.
[708] CCA 1974, ss 66A, 70.

contractual and post-contractual information to the consumer in regard to regulated credit agreements.[709] It has been argued that information requirements are designed to reduce the information asymmetry between the bank and consumer, and empowering the latter to take informed decisions, thereby protecting the consumer.[710] It has been claimed that, given that a consumer is especially vulnerable to the bank's post-contracting conduct, such conduct should be monitored.[711] It has been pointed out that the bank's information obligations following contract conclusion are scattered and overlapping, and need to be consolidated and simplified.[712] On the other hand, diminished levels of prescription have been criticised since they may make it more difficult for enforcement of compliance and a bank may not be trusted to flag significant risks and other necessary information if allowed excessive autonomy or flexibility.[713] It has also been argued that the CCA 1974 fails to furnish sufficient protection against over-indebtedness and irresponsible lending.[714]

It has been suggested that a review that includes all components of the consumer journey and considers the relevant obligations emanating from the FCA Consumer Credit sourcebook (CONC) could be beneficial. The goal would be to guarantee that a consumer is adequately motivated and able to take informed decisions.[715] It has been further retained that the information presently furnished, such as for arrears notices, default notices and fixed-sum statements, can be highly extensive and technical. It has been recognised, however, that it is crucial that the consumer is provided with a complete and updated view of their account, especially if they are vulnerable or in arrears.[716]

[709] FCA (n 682) para 6.4.
[710] ibid para 6.7.
[711] Eva Lomnicka, 'The Future of Consumer Credit Regulation' (2005) 7(2) Contemporary Issues in Law 184–210; see *Paragon Finance plc v Nash* [2001] EWCA 1466; [2002] 1 WLR 685; *Broadwick Financial Services Ltd v Spencer* [2002] EWCA 446.
[712] FCA (n 682) para 6.49.
[713] FCA (n 682) para 6.15.
[714] Swaby, Kelly and Richards, 'Bill of Sale Lending: Reforming a "Toxic" Form of Credit' (n 624).
[715] FCA (n 682) para 6.49.
[716] ibid para 6.51.

4.3.3 Sanctions and Unenforceability

Remarkably, heavily opposite opinions have been expressed on the sanctions and unenforceability provisions.[717] It has been claimed that sanctions, particularly disentitlement, are a significant self-policing instrument and a critical measure of consumer protection. Such statutory rights concerning a consumer's individual agreement cannot be replaced by the FCA's authority to initiate enforcement action against a firm for non-compliance.[718] It has been argued that automatic sanctions' self-policing character substantially helps to ensure adequate firm behaviour and protection to the consumer. Sole dependence on FCA supervisory, disciplinary and restitutionary powers is insufficient.[719] On the other hand, it has been contended that, when a mistake is slight and generates no, or minimal, harm, unenforceability and disentitlement can be excessive and unfair. It has also been argued that sanctions do not require to be self-policing and that this may still be ineffective given that an uncompliant firm may not remediate anyway. It has been claimed that, in this regard, an FCA's potential action is a satisfactory disincentive against non-compliance.[720]

Furthermore, it has been argued that criminal offences are designed to serve as a powerful hindrance to firms and a significant motive to adhere to core obligations.[721] Contrastingly, it has been contended that in many situations, firms' conduct issues may be solved through FCA's focused supervision or enforcement action grounded on the FSMA 2000's regulatory framework and FCA's rules, which include powers to mandate rectification or issue fines.[722] Additionally, the application of criminal offences to banks would be incompatible with FSMA 2000's overall approach.[723]

[717] ibid para 7.28.
[718] ibid para 7.31.
[719] ibid para 7.40.
[720] ibid para 7.29.
[721] ibid para 7.95.
[722] Ibid para 7.97.
[723] ibid para 7.98.

4.3.4 Judicial Protection – Unfair Relationships

In relation to unfair relationships, Section 140A of the CCA 1974 gives the court extensive discretionary authority to issue remedial orders or review a credit agreement in cases where a bank and its consumer have an unfair relationship. Moreover, it outlines the criteria which the court may take into account in assessing whether a relationship is unfair. It has been submitted that the court has no or practically no restrictions on the factors which it can take into account to find unfairness. Section 140B also furnishes the court with broad powers in terms of the orders it may issue when it decides that the relationship is unfair.[724]

It has been argued that the court's broad capacity under these provisions to examine credit agreements and realign a specific contractual relationship between a firm and consumer to achieve a fair compromise between them is a vital safeguard in consumer credit regulation.[725] It has been further asserted that such provisions have helped to contest unfair agreements because the court can evaluate both the price and other term's fairness, by considering the circumstances at the time the contract was signed, and the firm's behaviour, prior to, during and after the agreement is establishment.[726] However, it has also been contended that the courts have construed the provisions too rigidly and that statutory direction would be beneficial for the courts.[727] Contrastingly, it has been asserted that permitting the courts to interfere with contracts in such a manner causes confusion and doubt.[728] It has been claimed that the onus of proof may be too burdensome on the bank, this being conditional to how broadly the court interprets the term 'unfair'.[729] The onus is on the bank to prove that, on the balance of probabilities, the

[724] Duncan Henderson, 'Consumer Credit Reform and Personal Insolvency' (2006) 22(2) Tolley's Insolvency Law and Practice 62.
[725] FCA (n 682) para 5.48.
[726] ibid Annex 5, para 201.
[727] ibid Annex 5 para 202.
[728] ibid para 5.49.
[729] Henderson (n 724); Roger Tym Lovells, 'Can You Credit It? The Consumer Credit Bill' (2005) 20(10) Journal of International Banking and Financial Law 389.

relationship is not unfair due to a reason listed in section 140A(1) (a)-(c).[730]

The CCA 1974 makes no mention of what constitutes unfairness or unfair relationships. However, notably, giving the court broad powers to examine unfairness on a case-by-case basis was Parliament's conscious policy decision.[731] Parliament's key position was that courts must focus on the relationship's substance rather than the form, and that any legislative mandate would limit the courts' capacity to adapt to evolving market practices.[732] Parliament believed it to be critical for the criteria not to restrict or obstruct the courts' capability to administer justice in all cases.[733] It has been claimed that the absence of such a definition has generated doubt[734] and incongruent decisions.[735]

4.3.4.1 Notion of Unfairness

In *Plevin v Paragon Personal Finance Ltd* (*Plevin*),[736] the Supreme Court provided guidance on the meaning of unfairness. Notwithstanding the discretion was particular to the case, the Supreme Court noted that various general points could be drawn. First, even if the agreement's terms are not inherently unfair, unfairness may nevertheless exist since the relationship is so one-sided that it severely limits the consumer's capability to choose. Secondly, mere presence of characteristics that act sternly against the consumer does not inevitably mean that the relationship is unfair because these characteristics may be necessary to protect the bank's legitimate interests. Third, a material knowledge gap frequently exists between the bank and its consumer, the former possessing higher levels of financial knowledge and expertise and the relationship between them is intrinsically unequal in this regard. Yet, it could not have been Parliament's intention for these

[730] Sheppard (n 559).
[731] FCA (n 682) 5.53.
[732] Henderson (n 724).
[733] Lovells (n 729).
[734] ibid; FCA (n 682) para 5.53.
[735] FCA (n 682) para 5.53.
[736] *Plevin v Paragon Personal Finance Ltd* [2014] UKSC 61.

relationships' generality to be susceptible to reopening solely for such reason.[737]

According to the Supreme Court, a relationship is unfair if the lender, or someone on their behalf, fails to take reasonable measures necessary to ensure fairness. These measures should have eliminated the origin of unfairness or counterbalanced its effects so that the relationship could not be considered unfair anymore. It has been argued that whereas this is theoretically correct, in reality, it causes problems to a bank. What a bank should reasonably be expected to accomplish is fact-dependant and, thus, hard to foretell, especially through standard measures. Furthermore, since courts would judge unfairness retroactively, it will be hard for a bank to determine if a specific measure has eliminated the origin of unfairness before a court determines the issue.[738]

In *Plevin*, the Supreme Court overruled the Court of Appeal's widely critiqued ruling in *Harrison v Black Horse Ltd*.[739] Hence, an unfair relationship may be established even when a bank has not breached any relevant legal duty.[740] Section 140A(1)(c) of the CCA 1974 is engaged with whether an act or omission rendered the relationship unfair rather than with legal duties. The unfair relationship requirements were intended to furnish consumers more protection than their predecessors, namely, the extortionate credit bargain provisions.[741]

It is claimed that the CCA 1974 is emphatically a compelling and complicated legislation.[742] Many provisions of the CCA 1974 have the consequence of changing the

[737] Ibid [10].
[738] Skinner (n 559).
[739] *Harrison v Black Horse* [2012] Lloyd's Rep IR 521; [2010] All ER (D) 131.
[740] Jonathan Butters and Kevin Durkin, 'Unfair Relationships' (2015) 165(7642) New Law Journal 13; Simon Popplewell, 'The proposed new duty of care in financial services: what comes next?' (2019) 34(8) Journal of International Banking and Financial Law 522.
[741] Butters and Durkin (n 740).
[742] Daniella Lipszyc, 'Legislative loopholes' (2009) 159(7378) New Law Journal 1035.

parties' contractual rights.[743] However, it should be addressed cautiously[744] because some rules, notably those dealing with unfair relationships, are lengthy, complex and hard to foresee,[745] and may result in consumer disputes.[746] Moreover, while the CCA 1974's provisions are aimed to protect consumers, the latter may find it difficult to protect appropriately their own interests for a variety of reasons, including their status and banks' conduct.[747]

Further, it has been determined that certain sections, such as those relating to unenforceability and disentitlement sanctions, and unfair relationships, cannot be revoked without jeopardising consumer protection. This is due to the CCA 1974's unique approach to consumer protection and the inability of the FCA's present rule-making powers to recreate the same degree of protection. Hence, it is arguable that these provisions should have statutory footing either in the CCA 1974 or in another act.[748] However, it is also suggested that some provisions should be reformed to ensure a proportionate framework which offers an acceptable level of consumer protection. This is because these provisions fail to provide the protection and advantages that were intended.[749] For instance, it is arguable that the present information disclosure provisions need further scrutiny, irrespective of whether they are preserved in statutory law or substituted, wholly or partly, by the FCA rules. It would be possible to assess whether adequate goals are best attained by principles-based, prescriptive rules, or a mixture of both, if these provisions were to be substituted with FCA rules.[750]

[743] Julie Patient, 'Consumer credit: a new era approaches' (2013) 28(6) Journal of International Banking and Financial Law 358.
[744] Lipszyc (n 742).
[745] Sheppard (n 559); Skinner (n 559).
[746] Peter Sayer, 'The new UK consumer credit law: will you be ready?' (2010) 25(6) Journal of International Banking and Financial Law 362.
[747] Sarah Brown, 'Protection of the Small Business as a Credit Consumer: Paying Lip Service to Protection of the Vulnerable or Providing a Real Service to the Struggling Entrepreneur?' (2012) 41(1) Common Law World Review 59.
[748] FCA (n 682) paras 1.20, 1.31.
[749] ibid para 1.21.
[750] ibid para 1.28.

Therefore, it is arguable that although the CCA 1974 provides some degree of protection, given its deficiencies which have been highlighted in the above discussion, it fails to offer adequate consumer protection. Further, it is arguable that the CCA 1974 provides inadequate consumer protection because it only provides limited *ex ante* protection at the point of sale, that is, at the moment the contract is entered into, and an ambiguous, weaker degree of *ex post* protection post sale, following contract signature.[751] *Ex ante* protection is provided by imposing an authorisation framework,[752] restraining advertisements,[753] obliging lenders to disclose extensive information to prospective borrowers,[754] and furnishing cooling off periods.[755]

Ex-post protection is provided by granting the court an extensive jurisdiction to examine the fairness of credit agreement terms and that with which banks execute their legal rights.[756] In contrast to the CRA 2015, the CCA 1974's fairness evaluation covers all provisions, that is, including the essential terms, of the consumer credit agreement. Nonetheless, as discussed earlier, the Supreme Court endorsed a very restricted interpretation to this provision. The relationship is not unfair merely because certain provisions work harshly against the consumer; rather, those provisions may be necessary to safeguard what the court views as the creditor's legitimate interest.[757] According to the Court, disparities in financial knowledge and skill on their own are insufficient for revisiting an agreement because this 'cannot have been Parliament's intention'.[758] Indeed, in spite of a comprehensive legal framework, *ex post* reviews of credit contracts have rendered little in reality. Consequently, a credit agreement's *ex post* restructuring is extremely hard. Consumers have little certainty that banks will have a malleable, adaptive response in the

[751] Chiu, Kokkinis and Miglionico (n 562).
[752] CCA 1974, Part III.
[753] ibid Part IV.
[754] ibid s 55.
[755] ibid ss 66A-73.
[756] ibid ss 140A-140D.
[757] *Plevin v Paragon Personal Finance Limited* [2014] UKSC 61, [10] (Lord Sumption).
[758] ibid.

event that their situation and requirements alter after conclusion of the credit agreement, necessitating a significant amendment thereof.[759]

4.4 Conclusion

This chapter contends that statutory consumer law, specifically, the CRA 2015 and CCA 1974, fail to adequately protect bank customers. Although the CRA 2015 and CCA 1974 do not favour freedom of contract as much as, and are more paternalistic than, the common law of contract, nevertheless, they do not sufficiently intervene to provide the kind of impure paternalism emphasised in Chapter Two. Indeed, certain gaps are identified in such statutes. First, the CRA 2015's unfair terms provisions and the CCA 1974's unfair relationships provisions, in particular, are extensive, challenging to understand, and unpredictable. Second, despite the fact that the CRA 2015's assessment criteria are thorough, taking into account the nature of the contract and its context, and have a broad reach because they are applicable to all forms of consumer contracts, they only review whether the individual terms imposed were unfair. Furthermore, the relevant CRA 2015 provisions do not apply to the fairness of the contract's primary terms or the price's appropriateness when such terms are transparent and prominent. Contrastingly, the CCA 1974's unfair relationships provisions enable a court to examine individual terms and the manner in which the bank has exercised or enforced its rights under the agreement or any associated agreement, or any other action taken or not taken by the bank or on its behalf. The contract's main terms are also subject to the relevant CCA 1974 provisions. However, the latter only apply to one type of consumer contract, namely credit agreements, therefore, their applicability is limited. Consequently, the CRA 2015 only provides a weak form of *ex post* protection in the post-sale stage after a consumer contract is signed whereas the CCA 1974 provides consumers with some degree of *ex ante* protection at the point-of-sale stage and a vague form of *ex post* protection during the post-sale stage after the credit agreement is entered into.

[759] Chiu, Kokkinis and Miglionico (n 562).

Thus, this chapter demonstrates that the two main consumer protection statutes fail to provide adequate protection to bank customers because, whereas they do not advocate freedom of contract to the extent that the common law of contract does, they nonetheless do not provide the type of impure paternalism exalted in Chapter Two. Furthermore, together, the statutes primarily furnish a restricted degree of *ex ante* and *ex post* protection. Therefore, the chapter reinforces the overall argument of the thesis that a synthesis of private law and financial regulation is necessary for a complete, coherent system of finance law that provides adequate bank customer protection.

Chapter Five

The Limitations of Bank Customer Protection in Tort Law

5.1 Introduction

In English law, a consolidated tort notion is inexistent and as many diverse torts as basic tort rights subsist. These torts can be divided into various categories.[760] The main torts relevant to a bank-customer relationship are the tort of negligence and economic torts. The tort of negligence is the most extensive and crucial tort because it protects all legally acknowledged rights and interests.[761] It incorporates any circumstance wherein a bank has breached a duty of care owed to a consumer. All economic torts entail the deliberate imposition of economic harm.[762] Absent deceit, banks are unlikely to commit any other economic tort because such conduct will be futile. It is the banks' interests for customers to be successful.[763]

This chapter explores the extent to which tort law protects bank customers. It enquires whether it promotes freedom of contract or the type of impure paternalism endorsed in Chapter Two. To this end, the chapter analyses the tort of deceit, the tort of negligence generally, the tort of negligent misstatements/misrepresentation, the relationship between tort and contract, and the Misrepresentation Act 1967 (MA).

[760] Nicholas J McBride and Roderick Bagshaw, *Tort Law* (6th edn, Pearson Education Limited 2018) 5.
[761] Kirsty Horsey and Erika Rackley, *Tort Law* (6th edn, Oxford University Press 2019) 4.
[762] McBride and Bagshaw (n 760) 5-6.
[763] Parker Hood, *Principles of Lender Liability* (Oxford University Press 2012) para 7.172.

This chapter argues that tort law provides only limited *ex post* protection while it provides no *ex ante* protection. The chapter essentially contends that a fraud claim requires thorough evidence, which is hard to attain, and is discovered after it is too late to intervene as the transaction will have been concluded. Banks do not owe a general tortious duty to exercise reasonable care and skill or a tortious general advisory duty to customers. Moreover, the MA also provides inadequate protection because it furnishes no *ex ante* protection and a narrow degree of *ex post* protection due to its convoluted drafting, especially in holding that banks making an innocent misrepresentation that entices customers to enter into a contract consequent to which the latter suffer loss are liable as if the misrepresentation was carried out fraudulently. Although courts may provide a degree of ex post protection, they are hesitant to hold banks liable under a tortious duty of care in cases of refusing to provide advice or providing negligent advice to customers.

5.2 The tort of deceit

Deceit by banks via their employees is also uncommon. When deceit occurs, rather than intrinsic dishonesty, it is likely to comprise a transaction, or a driven or exuberant employee attempting to achieve a performance objective or a bonus.[764] The law on deceit is founded on case law.[765] The following are the essential components of the tort of deceit: (1) a representation of fact is made through words or conduct; (2) the representation is made 'knowingly, or without belief in its truth, or recklessly, careless whether it be true or false';[766] (3) the representation is committed with the intent that the claimant will act on it and cause them harm; and (4) the claimant has acted on the false representation and has suffered harm in so doing.[767] The first component describes the

[764] Hood (n 763) para 7.102.
[765] Sylvia Elwes, 'Misrepresentations made by directors and the requirement of writing' (2011) 4 (6) Corporate Rescue and Insolvency Journal 175.
[766] *Derry v Peek* (1889) 14 App Cass 337, 374.
[767] *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All ER 205; *ECO3 Capital Ltd v Ludson Overseas Ltd* [2013] EWCA Civ 413.

bank's actions. The second and third components delineate the bank's state of mind. The fourth component outlines the customer actions.[768]

A claim based on deceit has been recognised as having advantages. It is unnecessary to demonstrate that a special relationship exists between the parties. Thus, there is no requirement to prove the existence of a contractual or fiduciary relationship or a duty of care.[769] A bank's representation to the customer can comprise a representation to a group of individuals, including the particular customer who is relying thereupon.[770] When a professional, for instance, a bank, which has greater knowledge than the customer, makes a representation of opinion to the latter, there is also an implicit representation that the professional really deems that reasonable grounds exist to hold that opinion. Also, there is no autonomous criterion for an intention to deceive.[771] It is non-essential to illustrate that there was an intent for the customer to be induced to conclude a contract with the bank but only an intent for the customer to rest on the representation that resulted in their losses.[772] Furthermore, dishonesty is not a main prerequisite and the bank's motive is irrelevant.[773]

The foreseeability requirement applicable in negligence is inapplicable in deceit.[774] Indeed, in *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd*,[775] the House of Lords determined that the tort of deceit involves a broader remoteness test than reasonable foreseeability.[776] Moreover, remoteness of damage in the case of the tort of deceit varies from that of negligence because once liability is

[768] *ECO3 Capital Ltd v Ludson Overseas Ltd* [2013] EWCA Civ 413.
[769] Oliver Powell and Katarina Sydow, 'Bribery and corruption: what are the remedies available to those affected?' (2017) 23 (3) Trusts & Trustees 273.
[770] William Christopher, 'Credit Crunch Proceedings' (2009) 975 Tax Journal 10.
[771] *Eco 3 Capital Ltd v Ludsin Overseas Ltd* [2013] EWCA Civ 413; [2013] All ER (D) 172 (Apr); Peter Devonshire, 'Account of Profits for Dishonest Assistance' (2015) 74 The Cambridge Law Journal 222.
[772] *Derry v Peek* (1889) 14 App Cass 337.
[773] ibid.
[774] Powell and Sydow (n 769).
[775] *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1996] UKHL 3; [1997] AC 254.
[776] ibid; Andrew Burrows, 'We Do This At Common Law But That In Equity' (2002) 22(1) Oxford Journal of Legal Studies 1.

proven, all losses produced by the deceit, whether foreseeable or not, can be retrieved insofar they are a consequence of the tort.[777] The court will evaluate the customer's situation before the misrepresentation and thereafter, consequent to relying on it, when determining losses.[778]

It has been argued that, however, a fraud allegation entails some difficulties. Notwithstanding the lower burden of proof in civil actions, a fraud charge must be thoroughly documented and founded on reasonably credible evidence that demonstrates a *prima facie* fraud case. On one end, it has been claimed that there is a heavier standard of proof in terms of the evidence's cogency. The court bases its decision on the notion that the more severe the claim, the less likely the incident is to have taken place, and, hence, the more proof is required.[779] On the other end, it has been contended that the burden of proof in civil actions is based on the balance of probabilities and an allegation's severity does not entail a heavier burden.[780]

In *Derry v Peek*,[781] the House of Lords emphasised that in a deceit action, the claimant must demonstrate actual fraud.[782] Carelessness alone is unsatisfactory. A genuine conviction in the truth of a false statement is required to prohibit it from being fraudulent.[783] It has been submitted that proving the bank's mental state at the moment the representation was relied upon and harm resulted, specifically whether it knew the representation was false or had no honest conviction in its truth, will be a tough factor to prove.[784] Furthermore, understanding what mental states constitute intention and

[777] *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158 (CA); *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1996] UKHL 3; [1997] AC 254; *AIB Group (UK) plc* [2014] UKSC 58, [2014] 3 WLR 136; Peter Devonshire, 'Account of Profits for Dishonest Assistance' (2015) 74 The Cambridge Law Journal 222.
[778] *Marme Inversiones v Natwest Markets plc* [2019] EWHC 366 (Comm), [2019] All ER (D) 140 (Feb).
[779] Christopher (n 770).
[780] Simon Farrell and Joe Edwards, 'When the tide goes out' (2020) 170(7908) New Law Journal 11; see *Bank St Petersburg PJSC v Arkhangelsky* [2020] EWCA Civ 408, [2020] All ER (D) 137 (Mar).
[781] *Derry v Peek* (1889) 14 App Cass 337.
[782] ibid 368.
[783] ibid.
[784] Christopher (n 770).

recklessness is one thing; proving that a bank acted intentionally or recklessly is quite another. It might be difficult to put distinctions that are obvious in principle into reality.[785]

The position is even worse when the bank's frame of mind must be deduced from conduct and associated conditions. It has been acknowledged that, in such instances, a determination that an individual's conduct was intentional will be based on a claim about the average individual, not that individual. The average individual test is a rebuttable presumption of intention that recognises the difficulties of establishing intent. Given that it is rebuttable, the individual may avoid liability if they prove that the relevant conduct and its effects were unintended. Nevertheless, the truth is that this presumption effectively converts a determination of intention from an individual's subjective mental state into a statement about typical conduct.[786] Additionally, a bank customer may have difficulties with reliance and causation when seeking to launch civil proceedings for deceit. The bank customer must demonstrate that a causal link exists between the representation and the loss While the bank may intend for the customer to rest on the representation, the courts may be hesitant to conclude that the representation in fact operated on the customer's mind, causing them to behave in a particular manner.[787]

Thus, the tort of deceit may be beneficial for a bank customer.[788] Yet, difficulties exist. Whereas it may be feasible to institute a claim in deceit in particular situations, it is nonetheless unclear whether there are in effect circumstances which could prompt a claim in deceit. Furthermore, the successfulness of any such claim is highly contingent on an individual volunteering to disclose the relevant conduct.[789] Additionally, the customer generally trusts the bank and relies on its integrity, and the deceit is frequently revealed after the transaction has been completed, when it is too late to intervene.[790]

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[785] Peter Cane, 'Mens Rea in Tort Law' (2000) 20(4) Oxford Journal of Legal Studies 533 ibid 542.
[786] ibid 543.
[787] *JP Morgan Chase Bank v Springwell Navigation Corp* [2008] EWHC 1186 (Comm); Christopher (n 770).
[788] Farrell and Edwards (n 780).
[789] Christopher (n 770).
[790] Hood (n 763) para 7.102.

5.3 The tort of negligence

A bank may be held liable in tort for carrying out banking services negligently.[791] However, it is more probable for a bank to be found accountable for negligence when it furnishes negligent advice, or misstatements, to a customer.[792] Essentially, lending,[793] credit references,[794] investment[795] and financial instruments[796] are the four contexts wherein cases of alleged negligent advice have emerged. Yet, a bank has no general duty to advise a customer on a transaction's soundness or prudence.[797] For instance, in *Lloyds Bank v Cobb*,[798] the court ruled that in a typical bank-customer relationship, the bank does not have a contractual or tortious duty to advise the customer on the viability of a business initiative for which the bank is requested to make a loan.

A bank has a duty to advise when the customer makes such a request and the bank agrees to provide it,[799] or an arrangement exists between the bank and customer pursuant to which the bank must furnish advice.[800] Thus, a bank has an advisory function solely when it has been explicitly or implicitly accepted.[801] The principle is that the bank

[791] Hood (n 763) para 6.02; eg *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145, 1994] 3 All ER 506, 3 WLR 761.
[792] Hood (n 763) para 6.02; eg *Verity and Spindler v Lloyds Bank plc* [1995] CLC 1557.
[793] eg *Box v Midland Bank Ltd* [1979] 2 LI Rep 391; *Verity and Spindler v Lloyds Bank plc* [1995] CLC 1557.
[794] eg *Royal Bank Trust Co (Trinidad) Ltd v Pampellonne* [1987] 1 Lloyd's Rep 218; *Spring v Guardian Assurance plc* [1995] 2 AC 296.
[795] eg Woods v Martins Bank Ltd [1959] 1 QB 55; *JP Morgan Chase Bank (formerly known as Chase Manhattan Bank) v Springwell Navigation Corpn* [2008] EWHC 1186 (Comm); *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184;
[796] eg *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] CLC 518; *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch).
[797] *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205; *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340; *Lloyds Bank Plc v Cobb* (1991) 12 LDAB 210; *Verity and Spindler v Lloyds Bank plc* [1995] CLC 1557; *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] CLC 518; and *National Commercial Bank (Jamaica) Ltd v Hew's Executors* [2003] UKPC 51.
[798] *Lloyds Bank Plc v Cobb* (1991) 12 LDAB 210.
[799] ibid; *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205.
[800] *Lloyds Bank Plc v Cobb* (1991) 12 LDAB 210.
[801] Gregory Mitchell, 'To advise or not to advise?' (2014) 29 (11) Journal of International Banking and Financial Law 686.

is free to negotiate the best bargain for itself[802] and safeguard its interests.[803] However, when a bank does render advice to its customer, it must do so with reasonable skill and care.[804] Hence, banks owe a tortious duty of care to customers in the provision of banking services,[805] advice and information.[806]

This tortious duty emerges under specific circumstances and conditions. The analysis of whether a person is in a legal relationship with some other person as a result of which the former must take care to prevent harm to the latter is critical in the tort of negligence.[807] The duty issue results relatively rare in negligence lawsuits.[808] A bank is liable for its negligence when it owes a legal obligation to exercise care and breaches that obligation, causing damage.[809] The duty notion distinguishes between carelessly caused harm that encompasses breach of a duty to exercise care and carelessly caused harm that does not entail any duty and, therefore, does not give rise to liability.[810] Moreover, it is essential 'to determine the scope of the duty by reference to the kind of damage from which' the bank must exercise care to avoid harm to the customer.[811]

It has been claimed that negligence law comprises interpersonal justice as well as community welfare. The nature of the duty of care analysis and the rationale in duty cases suggest that negligence law serves a community welfare goal. This goal is absent in such concepts as compensation, deterrence and raising norms of conduct.

[802] *Lloyds Bank Plc v Cobb* (1991) 12 LDAB 210.
[803] *Morgan v Lloyds Bank plc* [1998] Lloyd's Rep Bank 73.
[804] ibid; Woods v Martins Bank Ltd [1959] 1 QB 55; *Cornish v Midland Bank plc* [1985] 3 All ER 513.
[805] Hood (n 763) para 6.01; *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; [1963] 2 All ER 575, [1963] 3 WLR 101; *Henderson v Merrett Syndicates* [1995] 2 AC 145, [1994] 3 All ER 506, 3 WLR 761.
[806] Hood (n 763) para 4.11; *Woods v Martins Bank Ltd* [1959] 1 QB 55; *Cornish v Midland Bank plc* [1985] 3 All ER 513; Morgan v Lloyds Bank plc [1998] Lloyd's Rep Bank 73. Hedley Byrne v Hellller; Henderson v Merrett Syndicates.
[807] John CP Goldberg and Benjamin C Zipursky, 'The Replacement (Third) and the Place of Duty in Negligence Law' (2001) 54(3) Vanderbilt Law Review 657.
[808] Christian Witting, 'Duty of Care: An Analytical Approach' (2005) 25(1) Oxford Journal of Legal Studies 33.
[809] *Donoghue v Stevenson* [1932] AC 562.
[810] McBride and Bagshaw (n 760) 79; Horsey and Rackley (n 761) 42.
[811] *Caparo Industries plc v Dickman* [1990] 2 AC 605, 627.

Interpersonal justice is better at serving this objective. Thus, it is arguable that negligence law advances the public interest by furnishing a civil remedy for particular interpersonal misconduct. This argument indicates the reason for the duty analysis to focus mainly on interpersonal justice issues but also to address the community welfare consequences of the imposition of liability, as do other private law doctrines. It explains satisfactorily the link between justice and welfare in the settlement of duty of care issues. The nature of duty of care analysis and rationale employed in duty of care cases vigorously indicate that judges act under the assumption that there is an inherent community welfare interest in such a judicial system.[812]

It has been contended that, although the differentiation between interpersonal justice and community welfare may be obfuscated, it is crucial at the decision-taking level. At such a level, justice and welfare are engaged with very diverse queries, which assist in identifying the problem. Moreover, the duty framework establishes a priority relationship between justice and welfare elements. Such a relationship solves the tension between them.[813] The treatment of community welfare as a distinct element clarifies that particular community welfare advantages are not required to create a duty. Nonetheless, if a duty is denied, compelling harm will occur to the community welfare.[814]

Further, for a bank customer to succeed in a claim in negligence, they must prove all the following criteria: (1) the bank owed a duty of care to the customer; (2) the bank breached this duty; (3) the bank's breach caused loss or damage to the customer; and (4) such loss or damage is not too remote, that is, it is within the duty's scope and, hence, actionable.[815]

[812] Andrew Robertson, 'On the Function of the Law of Negligence' (2013) 33(1) Oxford Journal of Legal Studies 31.
[813] Andrew Robertson, 'Justice, Community Welfare and the Duty of Care' (2011) 127 Law Quarterly Review 370.
[814] Robertson, 'On the Function of the Law of Negligence' (n 812).
[815] McBride and Bagshaw (n 760) 72; Jenny Steele, *Tort Law: Text, Cases, and Materials* (4th edn Oxford University Press 2017) 116.

It has been argued that it is unclear how the notion of involuntariness, which is not specified as a criterion of the tort of negligence, functions within the framework of this tort. Three options have been recommended in this regard. First, involuntariness may be a stand-alone criterion of the tort. Secondly, involuntariness is not an autonomous criterion of the tort, however, it may prevent one or more of the other distinct criteria from being met. For instance, when involuntariness is invoked, the defendant will not be in breach of their duty of care. Third, involuntariness may operate as a defence, hence, notwithstanding that all the criteria of the tort of negligence are fulfilled, liability will not be established. It is worth noting that certain options are mutually exclusive. It is hard to understand how involuntariness can function as a standalone criterion and as a defence. Permitting involuntariness to be both would be superfluous.[816] In *Dunnage v Randall*,[817] the court construed involuntariness strictly such that rationally involuntary conduct is excluded from its ambit. However, the court absconded from clarifying how involuntariness precludes liability from developing in the tort of negligence.[818]

5.3.1 The Duty of Care

A fundamental element in determining a defendant' s liability for negligence is the existence of a duty of care.[819] It has been claimed that identifying appropriate decision-making factors to establish a duty of care in negligence is highly challenging[820] and fraught with uncertainty.[821] Since *Donoghue v Stevenson*,[822] courts have viewed the tort of negligence and duty of care with a focus on a generic notion of duty ascertainable by a straightforward test. In essence, Lord Wilberforce's two-stage test[823] was ultimately

[816] James Goudkamp and Melody Ihuoma, 'A tour of the tort of negligence' (2016) 32(2) Journal of Professional Negligence 137.
[817] [2015] EWCA Civ 673.
[818] Goudkamp and Ihuoma (n 816).
[819] Witting, 'Duty of Care: An Analytical Approach' (n 808).
[820] ibid.
[821] Keith Stanton, 'Defining the duty of care for bank references' (2016) 32 Journal of Professional Negligence 272.
[822] [1932] AC 562.
[823] *Anns v Merton London Borough Council* [1978] AC 728.

substituted by the more rigorous Lord Bridge's three-stage test, with incremental constraints.[824] On the other hand, Lord Goff's 'assumption of responsibility' test has functioned as the benchmark of liability in the thorny field of pure economic loss.[825] Despite these tests provide some comfort in the tort's chaotic reality, generality is unattainable.[826]

The three-stage test developed in *Caparo Industries plc v Dickman* (*Caparo*)[827] has been identified as a basic test to ascertain a duty of care.[828] However, in the sphere of economic loss, in *Customs & Excise Commissioners v Barclays Bank*,[829] the House of Lords strongly refuted this generic duty attitude.[830] Academics also slammed the concept of a generic standard for duty of care.[831] Stapleton contended that the *Caparo* three-stage test, assumption of responsibility test as well as other tests are fundamentally cyclical and, hence, hollow names.[832] Her criticism was upheld by the courts. In *Parkinson v St James* and *Seacroft University Hospital NHS Trust*,[833] Lord Justice Brooke recognised five plausible tests to determine the duty query: the three-stage test; assumption of responsibility test; development by analogy with identified categories; distributive justice; and an investigation into the objective of the defendant's service. His Lordship held that these approaches 'were not exhaustive'.[834]

[824] *Caparo Industries plc v Dickman* [1990] 2 AC 605.
[825] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.
[826] Jonathan Morgan, 'The rise and fall of the general duty of care' (2006) 22(4) Journal of Professional Negligence 206.
[827] [1990] 2 AC 605.
[828] Donal Nolan, 'Assumption of Responsibility: Four Questions' (2019) 72(1) Current Legal Problems 123.
[829] [2006] UKHL 28, [2007] 1 AC 181.
[830] Morgan (n 826).
[831] Stanton (n 821).
[832] Jane Stapleton, 'Duty of Care and Economic Loss: A Wider Agenda' (1991) 107 Law Quarterly Review 249.
[833] [2001] EWCA Civ 530; [2002] QB 266.
[834] ibid [27].

5.3.2 The *Caparo* Three-Stage Test

Nevertheless, *Caparo Industries plc v Dickman (Caparo)*[835] is the main case for determining a duty to exercise reasonable care and skill in the tort of negligence[836] wherein the House of Lords confirmed that such a duty exists when the following three factors are ascertained: (1) The claimant is reasonably foreseeable, that is, it is reasonably foreseeable that the claimant can suffer damage consequent to the defendant's failure to exercise care; (2) The claimant and defendant are in a proximity relationship; and (3) It is fair, just and reasonable in the circumstances to inflict a duty of a certain scope upon the defendant to avoid such damage to the claimant.[837] Their Lordships were decisive to eschew efforts attempting to establish a generic concept of duty. Their Lordships wanted to depart from the rulings in *Donoghue v Stevenson*[838] and *Anns v Merton London Borough Council*.[839] These decisions held that foreseeability of damage was sufficient to establish a *prima facie* duty of care. Such a duty would be denied solely for public policy reasons. Their Lordships favoured a restoration to the 'more traditional categorisation of different specific situations as guides to the existence, the scope and the limits of the varied duties of care which the law imposes'.[840]

It has been argued that the *Caparo* three-stage test furnishes a theoretical architecture to resolve duty of care queries. The test's requirements appear to direct the courts' scrutiny to issues pertinent to determining whether a legal relationship between the disputing parties should be acknowledged or not. However, the test's application has sparked substantial debate. Their Lordships' failure to dare beyond simple narratives of the situations wherein each test's factor typically exists and stipulate its purpose in the examination of new fact circumstances has been one source of contention. The courts

[835] [1990] 2 AC 605.
[836] Christian Witting, *Street on Torts* (15th edn, Oxford University Press 2018) 36.
[837] *Caparo Industries plc v Dickman* [1990] 2 AC 605.
[838] *Donoghue v Stevenson* [1932] AC 562.
[839] *Anns v Merton London Borough Council* [1978] AC 728.
[840] *Caparo Industries plc v Dickman* [1990] 2 AC 605, 618.

have not elucidated the relevance of each requirement, especially, that each requirement plays a diverse role in the duty query. The appellate courts' failure to follow a uniform strategy to the test's application has been another source of contention.[841]

Hence, unsurprisingly, the Caparo three-stage test's effectiveness has been repeatedly contested. Notwithstanding that the test is still employed to determine duty queries, it has been contended that the foreseeability and proximity notions obscure these queries. The proximity notion conceals the true policy-grounded justifications to reach specific duty decisions. Such justifications should be voiced forthrightly.[842] However, it has been counter argued that every factor, when understood correctly, serves a distinct role[843] in a legal relationship's establishment, is essential to the duty query and should not be conflated with the others.[844] The three-step test's factors are designed to determine whether there are any normatively important criteria which warrant the infliction of a rigorous legal duty to exercise care on the defendant.[845]

Further, it has been argued that, on doctrinal level, a duty of care is principally inflicted due to peripheral concerns of interpersonal accountability, driven by the pursuit of interpersonal justice. Justice necessitates that an individual must compensate for the damage resulting from wrongful conduct. Interpersonal responsibility determines whether careless behaviour which causes damage is improper in the pertinent manner. The three-stage test is employed to evaluate whether the defendant ought to have been aware of the claimant's interests, chiefly by invoking the foreseeability and proximity prerequisites.[846]

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[841] Witting, 'Duty of Care: An Analytical Approach' (n 808).
[842] eg Bob Hepple, 'Negligence: The Search for Coherence' (1997) 50 Current Legal Problems 69; Kit Barker, 'Unreliable Assumptions in the Modern Law of Negligence' (1993) 109 Law Quarterly Review 461; Jane Stapleton, 'Duty of Care Factors: a Selection from the Judicial Menus' in Peter Cane and Jane Stapleton (eds), *The Law of Obligations: Essays in Celebration of John Fleming* (Clarendon Press 1998), 67; Stapleton, 'Duty of Care and Economic Loss: A Wider Agenda' (n 832).
[843] D Owen, 'Duty Rules', (2001) 53 Vanderbilt Law Review 767.
[844] Witting, 'Duty of Care: An Analytical Approach' (n 808).
[845] ibid.
[846] Robertson, 'On the Function of the Law of Negligence' (n 812).

5.3.3 The Duty of Care in Pure Economic Loss

A bank's negligent conduct or advice usually causes pure economic loss to the customer.[847] Pure economic loss is monetary loss which originates directly from the damage which the negligent act or omission causes, that is, it is not consequent to any other sort of damage.[848] It includes money spent and lost profit, or profit chances foregone, as a direct consequence of the damage.[849]

In pure economic loss cases, ordinarily, English courts have been sceptical and taken a restricted attitude to recognising a duty of care.[850] No general duty exists to exercise reasonable care to prevent pure economic loss.[851] Rather, as stated in *Spartan Steel and Alloys Ltd v Martin & Co Ltd*,[852] the basic rule, known as the exclusionary rule, is that pure economic loss cannot be recuperated. Reasons therefor comprise the esoteric character of financial losses; the indirect means whereby financial losses occur, frequently when individuals act following advice or rely on others' expertise; the difficulties to prove these losses; and policy concerns, particularly, the possibility for a rippling effect among subsequent individuals as well as the possibility for excessive and undefined liability.[853] Furthermore, the law emphasises tangible rather than intangible representations of wealth given that they are more essential to basic human requirements in most circumstances.[854] Moreover, bank credits and money currency serve no significant function in the construction of the self.[855] Also, it has been frequently suggested

[847] Hood (n 763) para 6.08.
[848] Horsey and Rackley (n 761) 188.
[849] see *Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd* [1973] QB 27 (CA); Witting, Streets on Torts (n 836) 80.
[850] Stapleton, 'Duty of Care and Economic Loss: A Wider Agenda' (1991) (n 845).
[851] *Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd* [1973] QB 27 (CA); *Greenway v Johnson Matthey Plc* [2016] EWCA Civ 408, [2016] 1 WLR 4487; Matthew Isaacs, 'Understanding the relationship between the duties in contract and the tort of negligence' (2019) 35(3) Journal of Professional Negligence 155.
[852] *Spartan Steel & Alloys Ltd v Martin & Co (Contractors) Ltd* [1973] QB 27.
[853] Christian Witting, 'Distinguishing between property damage and pure economic loss in negligence: a personality thesis' (2001) 21 Legal Studies 481.
[854] Witting, *Street on Torts* (n 836) 77-78.
[855] M Radin, 'Property and Personhood' (1982) 34 Stanford Law Review 957.

that liability for pure economic loss should be best handled elsewhere, for instance, under the economic torts or contract law.[856]

In this regard, it has been argued that the concept of damage embraced for pure economic loss cases is troublesome since it is deformed by their contractual context, causing practical challenges for claimants and analytic difficulties for professional negligence advocates. It has been claimed that it is worthwhile to consider whether such difficulties should be resolved within the current structure of contractual and tortious causes of action and the limitation framework, or whether they should be treated as insinuations for the creation of a hybrid cause of action, which should be freely recognised and discussed. It has been further suggested that the 'damage' definition adopted for pure economic loss cases should be reconsidered.[857]

Subsequent to *Hedley Byrne & Co Ltd v Heller and Partners Ltd* (*Hedley Byrne*),[858] the key exception whereby pure economic loss can be recuperated is assumed responsibility.[859] Thus, the courts typically use two tests for establishing a duty of care, the *Caparo* three-stage test and assumption of responsibility test, the relationship between them being ambiguous. As the previous section has demonstrated, the *Caparo* test investigates whether the damage which the claimant suffered was a foreseeable result of the defendant's negligence, whether the parties were in a proximity relation, and whether recognising a duty of care would be fair, just, and reasonable. The assumption of responsibility test investigates whether the defendant undertook responsibility for the claimant's interests and whether the claimant placed reliance on the defendant.[860]

[856] Horsey and Rackley (n 761) 187.
[857] Janet O'Sullivan, 'The meaning of damage in pure financial loss cases: contract and tort collide' (2012) 28(4) Journal of Professional Negligence 248.
[858] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465 (HL).
[859] ibid; *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 (HL).
[860] James Goudkamp and John Murphy, 'The Failure of Universal Theories of Tort Law' (2015) 21(2) Legal Theory 47.

According to relatively recent cases, the claimant must demonstrate that the defendant 'voluntarily assumed responsibility' to avoid pure economic loss to the former.[861]

The *Caparo* test has been discussed in the previous section. This section analyses the assumption of responsibility test.

5.3.4 The tort of negligent misstatements – the assumption of responsibility test

It has been affirmed that evidence of an 'assumption of responsibility' is the key conceptual prerequisite for the acknowledgment of a duty of care in misstatement cases.[862] In *Hedley Byrne*, the House of Lords established the tort of negligent misstatements and developed criteria for when and how it would apply. Their Lordships instituted the concept that negligence in the furnishing of misstatements or advice could result in liability notwithstanding that the only damage suffered was pure economic loss. The lack of a contract is immaterial.[863]

According to the House of Lords, a duty of care ensues in such cases when the following four criteria are satisfied: (1) The parties have a special trust and confidence, or a fiduciary, relationship; (2) the party rendering the advice or information assumed voluntarily the risk, whether explicitly or implicitly; (3) the other party relied on the advice or information; and (4) the reliance was reasonable in the existing circumstances.[864] These principles are examined in the following sections.

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[861] eg *Playboy Club London Ltd v Banca Nazionale Del Lavoro Spa v Playboy Club London Ltd* [2018] UKSC 43; Isaacs (n 851).
[862] Witting, 'Duty of Care: An Analytical Approach' (n 808).
[863] Witting, *Street on Torts* (n 836) 526.
[864] *Hedley Byrne & Co Ltd v Heller and Partners Ltd* [1964] AC 465 (HL).

5.3.4.1 Special Relationship

In *Hedley Byrne*, the House of Lords refrained from acknowledging a duty of care in the context of negligent misstatements based only on the *Donoghue v Stevenson*[865] neighbour principle. A more stringent condition than foreseeability of the loss had to be met. Their Lordships were cautious not to construct rules which could subject a statement maker to liability to a broad, indefinite group of claimants.[866] The claimant must demonstrate that the defendant made the statement in a special relationship circumstance wherein the claimant could reasonably place reliance on the defendant's skill and care and the latter could be perceived to have borne accountability for the statment's correctness.[867]

Case law has since clarified the 'special relationship' meaning and the instances wherein a duty of care must be acknowledged. Four criteria must be fulfilled so that a defendant is held accountable for financial loss caused by the provision of their negligent advice or information,: (1) The defendant must be wholly cognisant of the features of the transaction contemplated by the claimant pursuant to the information received; (2) The defendant must either provide that information directly to the claimant or be aware that it will be provided to them, or a restricted group that includes the claimant; (3) The defendant must particularly expect that the claimant will reasonably and rightly rely on such information in choosing whether to conduct the relevant transaction or not; (4) The reason for which the claimant relies on such information must be linked to interests that the defendant should be reasonably required to safeguard.[868]

[865] [1932] AC 562.
[866] Witting, *Street on Torts* (n 836) 82.
[867] *Hedley Byrne & Co Ltd v Heller and Partners Ltd* [1964] AC 465 (HL).
[868] *Caparo Industries plc v Dickman* [1990] 2 AC 605; see also *Smith v Bush* [1998] 2 All ER 577.

5.3.4.2 Voluntary assumption of responsibility

In *Hedley Byrne*,[869] the House of Lords claimed that the responsibility is engaged voluntarily rather than enforced by law.[870] The required proximity between the parties is effectively established by the voluntary undertaking, or assumption, of responsibility.[871] Such an undertaking is a function of the wider, generic proximity notion, whose definition differs across diverse classes of case law.[872] It may occur either broadly, in a typical bank-customer relationship, or particularly, regarding a specific transaction. When a typical relationship exists, all that is required is to demonstrate its existence and the duty of care ensues. When relying on a specific *ad hoc* relationship, it is vital to investigate the special facts to determine whether an explicit or implicit undertaking of responsibility exists.[873]

The employment of the 'assumption of responsibility' concept for the establishment of a duty of care has been widely criticised.[874] Whilst courts use the term 'assumption of responsibility' regularly, they have not yet provided a distinct definition thereof.[875] It has been remarked that courts are eager to deduce a defendant's voluntary assumption.[876] It has been further argued that the test obscures what the courts are truly accomplishing, namely, utilising various criteria to evaluate whether the imposition of a duty of care is justified.[877]

[869] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.
[870] see also *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.
[871] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; Hood (n 763) para 6.24.
[872] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; Steele (n 815) 373.
[873] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.
[874] Isaacs (n 851).
[875] Nolan (n 828).
[876] Andrew Robertson and Julia Wang, 'The Assumption of Responsibility' in Kit Barker, Ross Grantham and Warren Swain (eds), *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing 2015) 49.
[877] Isaacs (n 851).

Furthermore, notwithstanding that the courts often solicit the assumption of responsibility concept, its meaning, importance, necessity and place are all challenged.[878] Given that various judges appear to imply very diverse matters when they invoke the concept, it is hard to ascertain what they intend it to signify.[879] Academic disputes mirror judicial hesitation, as evidenced by the relatively recent publishing of an array of essays marking *Hedley Byrne*'s fiftieth anniversary. Four main schools of thought are distinguishable in the scholarly articles on assumption of responsibility: (1) Given the manner in which the courts apply it, the concept is basically senseless; it is either a defense for policy debates or for a supposedly more significant notion, for instance, proximity; (2) assumption of responsibility instances are in reality only situations of contractual liability less consideration; (3) liability should not be imposed in cases where courts apply the assumption of responsibility concept; and (4) assumption of responsibility is a unique *sui generis* legal duty, distinct from contract law and negligence law. Academic debates on assumption of responsibility are profound. There is just no prevalent ground among academics on this subject.[880]

5.3.4.2.1 Meaning of assumption of responsibility

It has been claimed that an 'assumption of responsibility' can refer to one of the following: (1) taking on a task, encompassing commencement of performance, that is, role accountability and undertaking's second meaning; (2) accepting a legal duty, that is, accepting accountability in the 'legal responsibility' meaning; or (3) promise or assuring, that is, undertaking's first meaning. Additionally, it has been submitted that, from an analysis of the cases, it seems that courts have assigned all three interpretations to the term, and in some cases, they have assigned more than one of such interpretations in the same ruling. The fact that, while these interpretations are unequivocal, the same act

[878] Nolan (n 828); Allan Beever, 'The Basis of the *Hedley Byrne* Action' in Kit Barker, Ross Grantham and Warren Swain (eds), *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing 2015) 91.
[879] Nolan (n 828).
[880] ibid; Robertson and Wang (n 876); Hepple (n 842); Robert Stevens, *Torts and Rights* (Oxford University Press 2007).

may result in an assumption of responsibility in more than one of such interpretations complicates matters further.[881]

The courts have furnished five main reasons for declining to acknowledge a legal duty of care: (1) the defendant undertook the task in a social or informal situation;[882] (2) the defendant explicitly negated legal responsibility;[883] (3) the provisions of a contract between the parties would be incompatible with legal responsibility acknowledgment;[884] (4) the parties intentionally constructed their commercial relations so as to escape direct liability between them, hence, an assumed duty of care would result in sidestepping this contractual arrangement;[885] and (5) legal responsibility acknowledgment would be against public policy.[886] These reasons may hold different weight in different situations and are not all-inclusive.[887]

It has been asserted that the duty of care that flows from an assumption of responsibility is distinct from a 'core negligence' duty, which is a duty necessarily owed merely through one's presence in the field rather than through the undertaking of a task for another. In contrast to core negligence law, the defendant may explicitly or implicitly modify the duty's content or scope by three methods: (1) ascertaining for whom the task is being carried out;[888] (2) demarcating the task's scope;[889] and (3) setting out the standard of care expected from the defendant which is decided by the skill or expertise that they proffer themselves as cherishing.[890] Any adjustment of the duty's content or scope is established objectively, taking cognisance of the defendant's words or actions,[891] and the case's

[881] Nolan (n 828).
[882] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465.
[883] ibid.
[884] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.
[885] ibid.
[886] Nolan (n 828).
[887] see *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; Nolan (n 841).
[888] *Playboy Club London Ltd v Banca Nazionale Del Lavoro Spa* [2018] UKSC 43, [2018] 1 WLR 4041.
[889] eg *Calvert v William Hill Credit Ltd* [2008] EWCA 1427, [2009] Ch 330.
[890] eg *Philips v William Whiteley Ltd* [1938] 1 All ER 566.
[891] eg *Playboy Club London Ltd v Banca Nazionale Del Lavoro Spa* [2018] UKSC 43, [2018] 1 WLR 4041.

circumstances.[892] Such circumstances include the type of requests made;[893] social or business settings;[894] the defendant's status and special skill or knowledge;[895] knowledge of the claimant or class encompassing the claimant;[896] payment for information or advice;[897] objective of information or advice;[898] and the provision of advice or mere information.[899]

5.3.4.2.1.1.1 Reliance

In *Caparo*, Lord Oliver confirmed that '[t]he damage which may be occasioned by the written [or spoken] word is not inherent'.[900] Solely when a statement is relied upon does it have the capacity to result financial loss. It has been suggested that reliance establishes the causal connection between the defendant's failure to exercise care and the claimant's ensuing financial loss.[901] Reliance must be reasonable in the context.[902] It is debatable whether reliance has any further function besides the provision of the causal connection.[903] Customarily, the courts have considered reliance to be directly important in the determination of the duty query.[904] However, there has been a trend to downplay the significance of reliance as a duty criterion. This progression has been advantageous. The reasoning has been expressed with reference to proximity, which is

[892] Nolan (n 828).
[893] see *Hedley Byrne & Co Ltd v Heller & Partners* [1964] AC 465; *White v Jones* [1995] 2 AC 207;
[894] see *Hedley Byrne Co Ltd v Heller & Partners* [1964] AC 465; *Royal Bank Trust Co (Trinidad) Ltd v Pampellonne* (1986) 35 WIR 392, [1987] 1 Lloyd's Rep 218.
[895] see *Hedley Byrne Co Ltd v Heller & Partners* [1964] AC 465; *Spring v Guardian Assurance plc* [1995] 2 AC 296
[896] see *Hedley Byrne Co Ltd v Heller & Partners* [1964] AC 465 [1964] AC 465; *Playboy Club London Ltd v Banca Nazionale Del Lavoro Spa* 2018] UKSC 43, [2018] 1 WLR 4041.
[897] see *Howard Marine & Dredging Co Ltd v A Ogden & Sons (Excavations) Ltd* [1978] 1 QB 574
[898] *Harris v Wyre Forest DC* [1990] 1 AC 831; *Shaddock & Associates Pty Ltd v Parramatta City Council* (1981) 150 CLR 225; *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1360; *Western Trust & Savings Ltd v Strutt & Parker* [1999] PNLR 154.
[899] *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184.
[900] [1990] 2 AC 605, 635.
[901] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145; *Williams v Natural Life Health Foods Ltd* [1998] 1 WLR 830 (HL); [1998] 2 All ER 577.
[902] *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465; *Caparo Industries plc v Dickman* [1990] 2 AC 605; *NRAM Limited v Steel* [2018] UKSC 13.
[903] Witting, 'Duty of Care: An Analytical Approach' (n 808).
[904] See *James McNaughton Paper Group Ltd v Hicks Anderson & Co* [1991] 2 QB 113.

focused on the manner the defendant was positioned in relation to the claimant before any wrongful act or omission.[905] Reliance may assist to demonstrate that there was an ongoing, mutual relationship between the parties.[906] Stevens[907] and Nolan[908] have argued that liability for assumption of responsibility can emerge even when reliance is absent or, minimally, implied. No reliance is needed in any way.[909] The defendant's potential influence on the claimant is not determined by reliance. Reliance is simply used to emphasise the requisite that the claimant suffered harm consequent to the defendant's negligence.[910]

5.3.4.2.2 Importance of the Assumption of Responsibility

The prevailing rule in English law is that no duty of care exists in cases of pure economic loss. Following *Hedley Byrne*, pure economic loss may be retrievable in negligence when the defendant assumed responsibility towards the claimant. Ordinarily, the assumption of responsibility concept is claimed to encompass relationships 'in which a duty to take positive action typically arises'.[911] Furthermore, subsequent to *Hedley Byrne*, assumption of responsibility applied restrictively to negligent misstatement cases. However, in *Henderson*, Lord Goff extended it to the negligent performance of services.[912]

The degree of the importance of assumption of responsibility has been disputed. It has been claimed that, generally, save assumption of responsibility cases, no action in negligence is available for pure economic loss.[913] This assertion is conflicting with the

[905] Witting, 'Duty of Care: An Analytical Approach' (n 808).
[906] ibid.
[907] Robert Stevens, *Torts and Rights* (Oxford University Press 2007) 14.
[908] Donal Nolan, 'The Liability of Public Authorities for Failing to Confer Benefits' (2011) 127 Law Quarterly Review 260.
[909] *Banbury v Bank of Montreal* [1918] AC 626 (HL); Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[910] Joshua Griffin, 'Pure Economic Loss: Out of Negligence and into the Unknown' (2014) 3 Oxford University Undergraduate Law Journal 44.
[911] *Michael v Chief Constable of South Wales Police* [2015] UKSC 2, [2015] AC 1732 [100].
[912] Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[913] *White v Jones* [1995] 2 AC 207, 257.

House of Lords' comments in *Customs and Excise Commissioners v Barclays Bank plc* (*Customs and Excise Commissioners*).[914] Furthermore, in recent Supreme Court economic loss decisions, the concept has been deemed to be decisive of the duty query[915] and depicted as 'the foundation of this area of law'.[916] Therefore, it is argued that, normally, such cases conform widely with the assertion that assumption of responsibility is typically decisive of the existence or otherwise of a duty of care.[917]

5.3.4.2.3 Necessity of the Assumption of Responsibility

It has been maintained that the defendant does not owe any legal commitment to the claimant's economic interests until the claimant has furnished remuneration.[918] This standing is based on the idea that as long as no payment is made for information, advice or service, no legal right of care should be had in the provision thereof. It has also been argued that whilst liability should be inflicted in most relevant cases, this should be carried out on another basis. It has been claimed that one option can be contract. Another option is to avoid assumption of responsibility and decide the duty query in such cases by using a universally applicable approach.[919]

Two approaches have been recommended. One is founded on proximity and linked to the *Caparo* three-stage test.[920] The alternative is a multifaceted strategy based on policy

[914] [2006] UKHL 28; [2007] 1 AC 181.
[915] *NRAM Ltd v Steel (Scotland)* [2018] UKSC 13, [2018] 1 WLR 1190; *Playboy Club London Ltd v Banca Nazionale Del Lavoro Spa* [2018] UKSC 43, [2019] 2 All ER 478.
[916] *Playboy Club London Ltd v Banca Nazionale Del Lavoro Spa* [2018] UKSC 43, [2019] 2 All ER 478 [7].
[917] Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[918] David Campbell, 'The Curious Incident of the Dog that did Bark in the Night-Time: What Mischief does *Hedley Byrne v Heller* Correct?' in Kit Barker, Ross Grantham and Warren Swain (eds), *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing 2015) 111.
[919] Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[920] Robertson and Wang (n 876); Christian Witting, 'What are We Doing Here? The Relationship Between Negligence in General and Misstatements in English Law' in Kit Barker, Ross Grantham and Warren Swain (eds), *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing 2015) 223.

that balances the arguments for and against responsibility.[921] Both approaches are based on the proposition that courts' use assumption of responsibility is just a cover for policy or proximity factors which presumably explain cases' outcome.[922] However, it has been contended that, in addition to being predicated on a flawed proposition, these approaches are of minor use.[923] It has been argued that proximity is actually an empty concept; it is useful for *ad hoc* decision-taking on duty of care queries unrestrained by precedent or principle. A multi-faceted policy-based strategy faces identical criticism, with the additional drawback that the frivolous and often misinformed policy discussion it raises functions solely to prolong, and increase the costs of, litigation produced by the resulting ambiguity.[924]

It has been asserted that, when correctly comprehended, assumption of responsibility is effectively a very useful concept required by negligence law. Three arguments have been advanced in the concept's support. First, in the relevant cases, it seems that the law is following moral standards. It appears to be perfectly reasonable for the law to convert that enhanced moral obligation into a legal one. The second argument is intertwined with the first. While reliance is refused as a requirement of an assumption of responsibility, it is undeniably one reason why assumptions of responsibility generate moral and legal duties. Assumption of responsibility often and foreseeably stimulates reliance. It is reasonable that the law should deem the assumption of responsibility as a stand-alone duty, although frequently attended by reliance. The other argument is based on the premise that protecting freedom of conduct is the most crucial justification for minimising the primary negligent duty. The imposition of a general duty to undertake reasonable measures to benefit others to protect their economic interests poses a significantly greater risk to autonomy than does a minimal obligation to act in a way that does not damage others.[925] It has been submitted that there is not an argument in support of the

[921] Kit Barker, 'Negligent Misstatement in Australia – Resolving the Uncertain Legacy of *Esanda*' in Kit Barker, Ross Grantham and Warren Swain (eds), *The Law of Misstatements: 50 Years on from Hedley Byrne v Heller* (Hart Publishing 2015) 319.
[922] Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[923] Beever (n 828).
[924] Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[925] ibid.

assumption of responsibility concept which is authoritative. In fact, it has been pinpointed that no right or wrong response exists.[926] It has been claimed that, nonetheless, the concept is preferred.[927]

From the above analysis, it is evident that the assumption of responsibility concept is complicated.[928] It has been submitted that assumption of responsibility may be viewed as a broader, more malleable notion, that, although backed by fundamental principles, manifests itself differently in diverse situations.[929] It must be understood loosely and in line with the case's specific facts and policy concerns instead of being a crude notion which is either present or not in a given case.[930] It should be regarded 'as a sufficient but not a necessary condition of liability, a first test which, if answered positively, may obviate the need for further inquiry. If answered negatively, further consideration is called for'.[931]

5.3.5 The Relationship among the Tests used to establish a Bank's Duty of Care

According to the House of Lords in *Customs and Excise Commissioners*,[932] the assumption of responsibility test, the *Caparo* three-stage test and the incremental test – which requires courts to create novel classifications of negligence incrementally and by analogy with pre-existing ones – may be invoked to establish the existence or otherwise of a tortious duty of care.[933] Furthermore, the House of Lords analysed how the tests relate to one another. Their Lordships found that the *Caparo* three-stage test

[926] Tony Honoré, '*Hedley Byrne & Co Ltd v Heller & Partners Ltd*' (1965) 8 Journal of the Society of Public Teachers of Law 284, 299.
[927] ibid; Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[928] Donal Nolan, 'Deconstructing the Duty of Care' (2013) 129 Law Quarterly Review 559.
[929] Nolan, 'Assumption of Responsibility: Four Questions' (n 828).
[930] *Customs and Excise Commissioners v Barclays Bank plc* [2006] UKHL 28, [2007] 1 AC 181.
[931] ibid [4].
[932] ibid.
[933] see also *Sutherland Shire Council v Heyman* (1985) 127 CLR 424.

incorporates the assumption of responsibility test and that the latter is objective and independent of the defendant's subjective behaviour.[934]

Assumption of responsibility should be deemed to be a type of proximity, which is usually important in misstatement and negligent service provision cases. There is no necessity of further evidence of proximity between the parties if an assumption of responsibility is However, it is critical to recognise that both assumption of responsibility and proximity are organisation concepts, which guide attention to the more specific elements which connect the parties to each other. Moreover, in many cases, when the assumption of responsibility test is met, the third stage of the *Caparo* test is likely to be superfluous. A finding of assumption of responsibility is sufficient for the imposition of a duty of care.[935] It has been claimed that the House of Lords in *Customs and Excise Commissioners*[936] harmonised these two potentially conflicting tests to duty of care as alternatives.[937]

Nonetheless, prudence and logical thinking are normally beneficial companions to the judicial. In *Customs and Excise Commissioners v Barclays Bank plc*,[938] the House of Lords itself recognised that the three tests do not reveal any common norm by reference to which liability could be established, that all function at a high degree of generalisation and may frequently, although not always, yield an identical outcome. Similarly, in *Playboy Club*,[939] the Court of Appeal noted that the tests may be employed to assess one another and would typically generate the same outcome. What is important is how they are perceived in reality, and by what low-level criteria. Hence, the court would concentrate on the case's specific circumstances and the parties' distinctive relationship with reference to their factual and legal situation in its entirety.[940]

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[934] *Customs and Excise Commissioners v Barclays Bank plc* [2006] UKHL 28; [2007] 1 AC 181.
[935] ibid; Witting, *Street on Torts* (n 836) 49.
[936] [2006] UKHL 28; [2007] 1 AC 181.
[937] Steele (n 815) 467.
[938] *Customs and Excise Commissioners v Barclays Bank plc* [2006] UKHL 28, [2007] 1 AC 181.
[939] *Playboy Club London Ltd v Banca Nazionale Del Lavoro SpA* [2018] UKSC 43, [2019] 2 All ER 478.
[940] ibid.

It is affirmed that, therefore, effectively two tests may be employed to determine a bank's liability for negligence at common law, the assumption of responsibility test and the *Caparo* three-stage test. It has been suggested that if the case falls within the assumption of responsibility test, this is usually decisive[941] without any requirement of a separate consideration of policy matters.[942] When deciding whether a bank has assumed responsibility to a customer, courts will contemplate the situation objectively[943] rather than assessing what the bank intended or apprehended.[944] If there is no assumption of responsibility, the *Caparo* three-stage test is applied. In such cases, policy matters are essential because the 'fair, just and reasonable' criterion is evaluated in policy terms.[945]

Moreover, subsequently, the UK Supreme Court came to the conclusion that new cases should be determined on their own merits and the incremental method should not be used to evaluate novelty as a sole justification for refusing a duty of care. Contrastingly, for new claims, courts must take cognisance of reasonableness and judgment. Notwithstanding, the decision must be taken by considering the analogous cases uncovered and the case's particular factual circumstances, rather than to a direct appeal to high principles.[946] Contrary to what the incremental by analogy approach implies, absent clear precedent regulating the issue at hand, courts should not just dismiss the claim without considering the merits.[947]

Interestingly, it has been observed that while courts often employ the assumption of responsibility test in pure economic loss cases, the *Caparo* three-stage test is still applied in many cases. This is because courts use proximity criteria to determine whether there has been an assumption of responsibility and a special relationship.[948] The assumption

[941] Hood (n 763) para 6.50; Steele (n 815) 396.
[942] Steele (n 815) 396.
[943] *Henderson v Merrett Syndicate Ltd* [1995] 2 AC 145; *Customs and Excise Commissioners v Barclays Bank plc* [2006] UKHL 28; [2007] 1 AC 181.
[944] *Customs and Excise Commissioners v Barclays Bank plc* [2006] UKHL 28; [2007] 1 AC 181.
[945] ibid; Steele (n 815) 396-397.
[946] *Robinson v Chief Constable of West Yorkshire Police* [2018] UKSC 4; Horsey and Rackley (n 761) 72.
[947] ibid.
[948] Witting, *'Street on Torts'* (n 836) 99.

of responsibility test has been claimed to be really relevant in the few cases where there is proof that the defendant subjectively and voluntarily undertook responsibility to the claimant. Courts can establish a duty of care in conformity with the defendant's intents in such few cases but should apply the *Caparo* three-stage test in the other cases. It has been claimed that it is superfluous and confusing to maintain an 'objective' variant of the assumption of responsibility test besides the Caparo test.[949] It appears to be difficult to move beyond an intensely focused case-by-case study and come up with a consistent justification for the numerous strategies applicable to a particular case.[950]

5.3.6 Standard of Care

Once a bank customer has established that it was owed a duty of care by the bank, the customer must then demonstrate that the bank breached its duty by failing to exercise the level of care that was reasonable under the circumstances and that such breach caused the customer's loss.[951] It has been argued that no logical or legal reason exists for the bank's behaviour not to support a successful negligence claim.[952] Negligence law should focus on defendants that violate a certain level of conduct rather than on a set of rules purely engaged with inadvertent or careless conduct.[953]

According to case law, a bank should exert the same level of competence and care that a typical, competent banker would be expected to use in the circumstances. It is not expected to have the maximum degree of proficiency and validly divergent opinions are allowed.[954] The bank's conduct is assessed against the reasonable banker's objective

[949] ibid 50; Witting, 'What are We Doing Here? The Relationship between Negligence in General and Misstatements in English Law' (n 920).
[950] Steele (n 815) 398.
[951] Hood (n 763) para 6.76.
[952] John Murphy, 'The Nature and Domain of Aggravated Damages' (2010) 69(2) The Cambridge Law Journal 353.
[953] John Murphy, 'Rethinking Injunctions in Tort Law' (2007) 27(3) Oxford Journal of Legal Studies 509.
[954] *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582; [1957] 2 All ER 118; *Whitehouse v Jordan* [1981] 1 WLR 246; *Sidaway v Board of Governors of the Betlehem Hospital* [1985] AC 871;

standard, so-called the *Bolam* test. According to this test, a professional is not considered negligent if their conduct was in line with a norm which a responsible body of competent professional opinion acknowledged to be appropriate.[955] When determining whether the defendant satisfied the reasonable banker standard, the latter must be placed in the defendant's situation.[956] Hence, the objective standard will need to be amended taking into consideration the defendant's circumstances.[957] The notion is that the defendant's personal characteristics will be deemed to be an integral part of the defendant's situation and, therefore, considered. Nevertheless, while such logic may be appealing in the context of some defendants, it does not warrant subjecting all defendants to a strict objective standard.[958]

Yet, in *Dunnage v Randall*,[959] the court affirmed a stringent objective standard of care and stressed that the breach aspect of a negligence action should be unaffected by the defendant's personal traits. It has therefore been asserted that the court erred in suggesting that negligence law has always endorsed a solely objective standard of care.[960] An evaluation of the reasonable bank's conduct is dependent on the circumstances and a determination of how objective or subjective this test should be.[961] It has been further argued that, similar to the *Bolam* test,[112] a high bar for negligence would prohibit the court from guessing sensitive professional judgments, except in the egregious cases.[962] The difficulty in holding that no duty of care exists is that technically, no liability can ever be found in those circumstances, no matter how negligent the defendant was. A varied standard of fault, which appears to be implicitly acknowledged

Maynard v West Midlands Regional Health Authority [1984] 1 WLR 634; *Verity and Spindler v Lloyds Bank plc* [1995] CLC 1557.

[955] *Bolam v Friern Hospital Management Committee* [1957] 1 WLR 582.

[956] James Goudkamp and Donal Nolan, *Winfield & Jolowicz onTort* (20th edn, Sweet & Maxwell 2020) 146.

[957] *Mansfield v Weetabix Ltd* [1998] 1 WLR 1263 (CA); *Goldman v Hargrave* [1967] 1 AC 645 (PC); Goudkamp and Ihuoma (n 816).

[958] Tony Honoré, 'Responsibility and Luck: the Moral Basis of Strict Liability' (1998) 104 Law Quarterly Review 530.

[959] *Dunnage v Randall* [2015] EWCA Civ 673.

[960] Goudkamp and Ihuoma (n 816).

[961] Paula Giliker, 'Codification, Consolidation, Restatement? How Best to systemise the Modern Law of Tort' (2021) 70(2) International and Comparative Law Quarterly 271.

[962] Morgan (n 826).

in English negligence law, could safeguard critical decision-taking, yet allowing for liability for the most severe errors in judgment. A few English courts appeared to welcome this focus on breach of duty as a means of restricting responsibility.[963]

Further, whether or not a person acted reasonably should be determined on a case-by-case basis. Consequently, it is expected that the most significant tort standard – the obligation to act reasonably – is a target standard. Judges are scarce in regulatory competence, and litigation processes are unsuited to acquiring the kind of information required to establish effective specification and performance requirements. Courts' reluctance to set out such requirements is illustrated in the dichotomy between 'duty of care' and 'standard of care'. The former is considered a legal issue while the latter is held to be a factual issue. Standard of care refers to the measures that must be taken in specific circumstances to satisfy the duty to exercise reasonable care. Responses to legal issues generate precedent, or define tort standards, whereas replies to factual issues do not. Despite features of the reasonable care notion are conceived as legal matters, typically, courts are wary of using detailed assertions on how the particular defendant's conduct was unreasonable.[964]

5.3.7 Scope of the duty

After a duty of care has been established, it is critical to assess the 'scope of the duty', that is, whether the claimant's loss is covered by the duty.[965] A claimant must demonstrate that they were owed a duty of care and that it was due in light of the kind of loss endured.[966] A defendant is not liable for negligent advice, information or service in relation to which they did not owe a duty of care to the claimant and, therefore, they are not liable

[963] ibid.
[964] Peter Cane, 'Tort Law as Regulation' (2002) 31(4) Common Law World Review 305.
[965] Steele (n 815) 397.
[966] *South Australia Asset Management Co v York Montague Ltd* [1997] AC 191, [1996] 3 All ER 365.

for any loss consequent to the improper advise, information or service.[967] The provisions of a contract between the parties are key for the determination of the scope of the pertinent duty.[968]

In *Robinson v PE Jones (Contractors) Limited*,[969] the court declared a precise, comprehensive and compelling principle, namely, that *Hedley Byrne* liability can only exist when damage results to something other than the product furnished. In *Hedley Byrne*, their Lordships did not expand the tortious duty of care to economic losses that resulted by flaws in the quality of the thing itself. The court only expanded the duty to economic loss made to property besides the thing itself. In *Hedley Byrne*, the negligent credit reference or statement was the thing furnished, reliance was placed thereupon, harm resulted to the claimant as a consequence thereof and, hence, a tortious cause of action arose. In *Henderson,* the underwriting management services were the thing supplied and the conduct of one's affairs or control over their assets by someone else established the required reliance for the *Hedley Byrne* principle to be applicable.[970]

Consequently, the difference in tort between pure economic loss prompted by a person who furnishes a flawed thing, and pure economic loss prompted by a person who provides a thing which, due to it flaws, causes loss or damage to something else, is more important than initially held because it determines the scope of the *Hedley Byrne* duty of care. It has been held that this is critical as claims for flawed work or product fall properly into the area of warranty under contract rather than tort. Additionally, this core difference is applicable to all losses.[971]

[967] *Hughes-Holland v BPE Solicitors* [2017] 2 WLR 1029.
[968] Witting, *Street on Torts* (n 836) 99.
[969] [2011] EWCA Civ 9.
[970] Jonathan Carrington, 'A crucial distinction' (2014) 30(4) Journal of Professional Negligence 185.
[971] ibid.

5.4 Tort and Contract

Following *Henderson v Merrett Syndicates Ltd*,[972] it has been acknowledged that professional services providers, including banks, owe a tortious duty of care, which, normally runs simultaneously with an underlying contractual duty, to their customers. Hence, a defendant may owe a claimant two concurrent duties, the contents of which may partly or wholly coincide.[973] Yet, the relationship between such obligations is contentious, particularly, when the damages that the claimant can recover through one duty are larger than through the other. Essentially, academics are split into two opposing views. One view proposes that the tortious duty should be considered as a separate duty, independent from the contractual one.[974] It has been claimed that Lord Goff, in *Henderson v Merrett Syndicates Ltd*,[975] handled the two duties distinctively, each duty being discussed separately. The contractual duty is created by the parties' joint intent and the contract terms which govern the parties' relative rights and responsibilities. The tortious duty is imposed by the general law; it is created by a decision grounded on contextual elements. Given that each duty could be justified by itself, it makes sense to hold that the obligations could coexist notwithstanding that they arose from the same facts.[976]

Contrastingly, the second view holds that the tortious duty forms part of contract law, not negligence law, and is not independent from the contractual duty.[977] According to this view, the obligation assumed in situations where a contract would apply is basically contractual in character, however, courts were unable to recognise a real contract because of the need for consideration.[978] It has been argued that the judgment in

[972] [1995] 2 AC 145 (HL).
[973] Aaron Taylor, 'Concurrent Duties' (2019) 82(1) Modern Law Review 17.
[974] ibid; Robertson and Wang (n 876); Isaacs (n 851).
[975] [1995] 2 AC 145 (HL).
[976] Isaacs (n 851) Taylor (n 973).
[977] Beever (n 828).
[978] Taylor (n 973).

Henderson[979] cannot be justified on principle because the tortious duty is not independent from the contractual duty.[980] It has been further contended that Lord Goff distinguished the tortious duty because the service could be rendered without remuneration.[981] However, it has also been disputed that this does not account for circumstances wherein consideration is given.[982]

Furthermore, it has been argued that in cases involving concurrent liability, where the court relies on the assumption of responsibility concept to justify the defendant's tortious duty, such concept fails to adequately explain the creation of an independent tortious duty, or otherwise, dissuades the court from evaluating overtly all the pertinent contextual factors. This is troublesome especially since the concept seems to affect the scope of the tort of negligence. To this end, it has been argued that courts should stop using the assumption of responsibility concept for determining a duty of care in such situations. Rather, a court should merely enquire whether satisfactory justifications exist to establish a duty of care and weigh all elements for or against this finding, at least when setting precedent. This would ensure that the critical contextual elements are forthrightly analysed, making future courts' and commentators' understanding and evaluation of the decision easier.[983]

It has been further contended that, regardless of any contract, the courts should first determine the imposition or otherwise of a tortious duty and its extent. The courts should only thereafter take cognisance of any contract and query whether both parties intended to vary or exclude the tortious duty.[984] It has been claimed that the tortious duty would

[979] [1995] 2 AC 145 (HL).
[980] Andrew Burrows, 'Solving the problem of concurrent liability' in *Understanding the Law of Obligations: Essays on Contract, Tort and Restitution* (Hart Publishing 1998) 16–44, 26–31.
[981] ibid 29.
[982] Isaacs (n 851).
[983] ibid.
[984] *Henderson v Merrett Syndicates* [1995] 2 AC 145 (HL); Isaacs (n 851).

emerge notwithstanding that the contract was never consummated, or a contract existed but was later ended.[985]

Further, it has been asserted that the concurrent liability concept is more concerned with the *a priori* creation of simultaneous overlapping obligations than with remedies. When the defendant violates more than one obligation, the claimant may choose to sue for any of the breaches, and may recover any resulting remedies, save for the double-recovery prohibition.[986] It has been further suggested that, nonetheless, whereas the claimant may pursue both actions in parallel, they must always select between them prior to a judgment being granted in their favour.[987] The claimant may choose the more advantageous action. Any discrepancy between the tortious duty and the relevant contract must be considered.[988] When such a discrepancy is present, the contract prevails.[989] It has been claimed that the creation of concurrent duties may harm the advantage of the claimant's selection of these actions as one duty's content may influence the other's content.[990]

Another point of contention relates to the proper test regarding remoteness of damage where concurrent tortious and contractual duties coexist.[991] The test concerning remoteness of damage in contract is more stringent than that for remoteness in the tort of negligence.[992] Hence, a person may recover more in a tort claim than in a contract one. In this regard, it has been contended, that the tests should be identical and that the contractual test is more suitable.[993] Furthermore, according to a relatively recent judgment, the contractual rules regarding remoteness of damage apply to cases of

[985] Mark Cannon and others (eds), *Jackson & Powell on Professional Liability* (9th edn, Sweet & Maxwell 2021) para 2-121.
[986] ibid.
[987] *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1 (HL).
[988] *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 (HL), 190.
[989] ibid; see *Rowlands v Callow* [1992] 1 NZLR 178 (High Court of New Zealand) 190, approved in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145 (HL), 191.
[990] Taylor (n 973).
[991] ibid.
[992] Andrew Burrows, 'Solving the problem of concurrent liability' (1995) 48 Current Legal Problems 103.
[993] *Riyah Bank v Ahli United Bank (UK) Plc* [2006] EWCA Civ 780, [2006] 1 CLC 1007.

concurrent duties in contract and tort of negligence, irrespective of how the claim is structured.[994]

However, it has also been submitted that there are reasons to doubt whether using the contractual rules of remoteness when a contract exists between the parties is appropriate under tort law.[995] Firstly, it is doubtful whether the parties have always the option of varying the contractual allocation of risk.[996] Secondly, even if the parties can modify risk allocation, it is unlikely that the parties actually convey particular risks to one another. Thirdly, it is disputable that the tort of negligence is appropriately structured to induce parties to disclose risks. Fourthly, in the event that the contractual rules do encourage risk disclosure, such aspect will only be one criterion to be considered by the courts for determining the most adequate remoteness test applicable in tort. This criterion must be balanced against other crucial considerations, for instance, the requirement to protect vulnerable parties and that for consistency across the tort of negligence.[997]

Additionally, once the duties are seen as independent, albeit concurrent, it is normal for one duty to extend wider than the other, and it is doubtful whether the policy factors otherwise justify the contractual test for remoteness in the tort of negligence. Further, once the tortious duty is viewed as an independent duty, it is debatable whether the contractual test for remoteness should apply whenever there is a contract between the parties. Indeed, doing so risks denying potentially deserving claimants protection through the full scope of the tort.[998]

[994] *Wellesley Partners LLP v Withers LLP* [2015] EWCA Civ 1146, [2016] Ch 529.
[995] Isaacs (n 851).
[996] Aaron Taylor, 'Wither Remoteness' (2016) 79(4) Modern Law Review 678.
[997] Isaacs (n 851).
[998] ibid.

5.5 The Misrepresentation Act 1967

The Misrepresentation Act 1967 (MA) was enacted to clarify the situation relating to negligent misrepresentation because, despite the *Hedley Byrne* ruling, its scope was not entirely settled at the time.[999] This is no longer the case.[1000] Notably, Section 2(1) of the MA specifies that a person that makes an innocent misrepresentation which convinces another to enter into a contract, pursuant to which the latter suffers loss, should be 'so liable' to pay damages as if the misrepresentation was fraudulently. The action is claimed to generate a 'fiction of fraud',[1001] requiring innocent misrepresentation cases brought under section 2(1) to be regarded as if they were carried out fraudulently, especially for the evaluation of damages.[1002] In contrast to a deceit claim, section 2(1) does not require the bank customer to prove that the representation was fraudulent. It has been maintained that the legislation contains an extraneous reference to fraudulent misrepresentation.[1003]

The section was intended to create a contractual remedy of damages for non-fraudulent misrepresentations where no such remedy had been available at common law.[1004] However, in *Royscott Trust Ltd v Rogerson*,[1005] the Court of Appeal stated that the tortious measure, not the contractual measure, must be applicable based on the section's wording; the pertinent tortious measure is the one for fraud and not that for negligence. He held that the words 'so liable' signify liability as for fraudulent misrepresentation. This is significant because the claimant may recuperate all loss consequent to the defendant's fraud, including unforeseeable loss.[1006] Thus, the measure of damages pursuant to section 2(1) is wider than the tortious one for negligence, for which the loss must be

[999] *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All ER 573, 589.
[1000] See *Esso Petroleum Co Ltd v Mardon* [1976] QB 801.
[1001] PS Atiyah and GH Treitel, 'Misrepresentation Act 1967' (1967) 30 Modern Law Review 369, 373.
[1002] Elizabeth Palmer, 'The fiction of fraud' (1991) 141 (6533) New Law Journal 1732.
[1003] Hood (n 763) para 6.92.
[1004] Palmer (n 1002).
[1005] [1991] 2 QB 297.
[1006] *Doyle v Olby (Ironmongers) Ltd* [1969] 2 QB 158; [1969] 2 All ER 119; *East v Maurer* [1991] 1 WLR 463.

foreseeable.[1007] Had the measure been contractual, the claimant would be placed in the same situation as if the misrepresentation was true. It is hard to discern a justification for imposing a broader measure of damages for innocent misrepresentation in contract than what is available to the claimant for negligent misrepresentation in tort in a case of negligent misrepresentation falling within section 2(1), where dishonesty is not alleged.[1008]

Royscott Trust Ltd v Rogerson[1009] was highly criticised.[1010] It has been argued that although the correct measure is believed to be a tortious one, the deceit rule's strictness may solely be accepted in actual fraud cases and remoteness pursuant to section 2(1) should be dependent on the foreseeability test, as in an action in negligence.[1011] It has been further contended that Parliament's intention to introduce a reference to fraud could have been limited to contextualising the novel action by referring to the older common law. Previously, damages were solely available for fraud cases. Now damages are also available for non-fraudulent misrepresentation. It has been argued that this reasoning would not have inevitably created such a fraud fiction. Unfortunately, the Court of Appeal lost its opportunity to cast serious doubts on the appropriateness of the fraud fiction in assessing damages under section 2(1).[1012]

It has been contended that considerable uncertainty still exists on the MA's effect and scope. This is so when the MA is applied to comparatively simple contracts and the more so when applied to increasingly complicated arrangements which were not thought of when the act was passed. The Court of Appeal in *Taberna Europe CDO II plc v Selskabet*

[1007] *Overseas Tankship (UK) Ltd v Morts Dock and Engineering Co Ltd (The Wagon Mound (No 1)* [1961] AC 388 (PC).
[1008] Palmer (n 1002).
[1009] [1991] 2 QB 297.
[1010] Richard Hooley, 'Damages and the Misrepresentation Act 1967' (1991) 107 Law Quarterly Review 547. Doubts on the decision's correctness were also expressed by the House of Lords in *Smith New Court Securities Ltd v Scrimgeour Vickers (Asset Management) Ltd* [1997] AC 254.
[1011] Edwin Peel, *Treitel on The Law of Contract* (15th edn Sweet & Maxwell 2020) 320.
[1012] Palmer (n 1002).

af 1September 2008 A/S (formerly Roskilde Bank A/S)[1013] highlighted some of these complexities and legal inconsistencies.

In this case, one issue was whether statements in an 'investor presentation' document could be deemed to have been made to a purchaser in the secondary market when this document explicitly restricted its use to initial investors. Consistent with the common law position, Lord Moore-Bick LJ claimed that simply placing the financial information public, or posting it on one's website, is insufficient to induce liability under section 2(1) when that information ultimately proved to be false, lest the statement-maker had performed something more (for instance, 'actively [inviting] potential investors to make use of information originally produced for a different purpose')[1014] or actually knew or foresaw that an identified party (other than the initial investor) would be relying on the information to contract with the statement-maker.[1015] It has been suggested that, in light of the possibly harsh remedial ramifications of section 2(1), it is necessary for the courts to embrace the common law's caution and utilise the word 'to' so as to substantially restrain the possibility of indeterminate liability.[1016]

It has been further argued that the interpretation of section 2(1) in Taberna leads to troubling legal anomalies. First, the remedial position of an investor who was persuaded to buy financial instruments on the primary market differs from that of a buyer on the secondary market who relied on the same false statements. Whereas the former has a a strong statutory damages claim and the potential for rescission, the latter is restricted to rescission[1017] and may solely recover damages for consequential loss to the degree allowed under the torts of deceit or negligence. It has been further submitted that,

[1013] [2016] EWCA Civ 1262, [2017] 3 All ER 1046.
[1014] ibid [11].
[1015] *Cramasco LLP v Ogilvie-Grant* [2014] UKSC 9
[1016] Christopher Hare, 'Further twists and turns in the labyrinth of statutory liability for misrepresentation' (2017) 32(9) Journal of International Banking and Financial Law 535.
[1017] see *Edgington v Fitzmaurice* (1885) 29 Ch D 459, 481.

however, this discrepancy is uncontentious because the common law has always made a similar differentiation to limit liability.[1018]

Second, it has been asserted that the MA's provisions are applied inconsistently. On Taberna's facts, section 2(1) was properly deemed to be inapplicable based on the premise that rescission would have been possible in the circumstances.[1019] In regard to section 2(2), there is nothing in its wording to prohibit it from being applicable; the court's discretion is triggered '[w]here a person has entered into a contract after a misrepresentation has been made to him'; there is no additional requisite regarding the representor's identity.[1020] Contrastingly, section 3 is solely applicable if the other contracting party makes the representation. Notably, these anomalies are due to the statute's drafting and the *Taberna* judgment simply draws attention to them.[1021] It has been claimed that, ultimately, *Taberna* may have just helped to emphasize what has long been acknowledged,[1022] namely, that the Court of Appeal in *Royscot Trust* erred when it intrerpreted the 'fiction of fraud' in a manner that included the deceit concepts within section 2(1).[1023]

Moreover, a question which has been controversial and divided judicial opinion is whether section 3 of the MA is applicable to no-representation and non-reliance clauses. Prior to the Court of Appeal's judgment in *Springwell Navigation Corpn v JP Morgan Chase Bank* (*Springwell*),[1024] there were a number of decisions which held that non-reliance clauses were subject to section 3.[1025] In *Springwell*, the Court of Appeal determined that various

[1018] Hare (n 1016) 537.
[1019] See *Taberna Europe CDO II plc v Selskabet af 1September 2008 A/S (formerly Roskilde Bank A/S* [2016] EWCA Civ 1262, [2017] 3 All ER 1046 [48]; Hugh Beale (ed), *Chitty on Contracts*, vol 2 (34th edn, Sweet & Maxwell 2021) para 7-111.
[1020] *William Sindall plc v Cambridgeshire County Council* [1994] 1 WLR 1016.
[1021] Hare (n 1016) 537.
[1022] Hooley (n 1010).
[1023] *Avon Insurance Ltd v Swire Fraser* [2000] 1 All ER (Comm) 573, 633; *Yam Seng Pte Ltd v International Trade Corporation Ltd* [2013] EWHC 111 (QB), [206]; cf *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd* [2011] EWHC 484 (Comm), [223].
[1024] [2010] EWCA Civ 1221.
[1025] *Thomas Witter Ltd v TBP Industries Ltd* [1996] 2 All ER 573; *Government of Zanzibar v British Aerospace (Lancaster House) Ltd* [2000] 1 WLR 2333.

contractual terms, which included no-representation and non-reliance clauses, raised contractual estoppel that prevented *Springwell* from arguing that it had actionable representations. Aikens LJ acknowledged that certain clauses, including some no-representation and non-reliance clauses, were 'genuine exclusion clauses' and, therefore fell, within section 3 but they were found to be reasonable on the facts of that case. Following *Springwell*, certain decisions confirmed that similar non-reliance and no-representation clauses raised contractual estoppel that precluded the MA's statutory controls because they were basis clauses rather than exclusion clauses.[1026]

First Tower Trustees v CDS (Superstores International) Ltd (*First Tower Trustees*)[1027] clarified the law on this issue. It established that a clause may amount to an effective contractual estoppel but may still be subject to statutory controls under section 3.[1028] *First Tower Trustees* is an important decision because it clarifies the test to be applied when determining whether section 3 applies to particular contractual clauses. Crucially, the question whether section 3 applies is one of statutory interpretation rather than contract interpretation. When a contract term seeks to exclude liability, which, given the facts would otherwise exist, it is an exclusion clause that falls under section 3. To hold otherwise would be defeating section 3's policy, which is 'to prevent parties from escaping liability for misrepresentation unless it is reasonable for them to do so'.[1029]

Notably, in two recent decisions considering *First Tower Trustees,*[1030] namely, *BNP Paribas SA v Trattamento Rifuti Metropolitani SpA*[1031] and *Fine Care Homes Limited v*

[1026] *Barclays Bank plc v Svizera Holdings BV* [2015] 1 All ER (Comm) 788; *Thornbridge Ltd v Barclays Bank Plc* [2015] EWHC 3430 (QB); *Sears v Minco plc* [2016] EWHC 433 (Ch).
[1027] [2018] EWCA Civ 1396.
[1028] Catherine Gibaud, 'Does First Tower Trustees change the landscape for document-based defences to mis-selling claims?' (2019) 34(6) Journal of International Banking and Financial Law 363; Catherine Gibaud and Kate Holderness, 'Do BNP v Trattamento and Fine Care v Natwest show the courts retreating from the principles established in First Tower Trustees?' (2021) 36(7) Journal of International Banking and Financial Law 465.
[1029] ibid.
[1030] [2018] EWCA Civ 1396.
[1031] [2020] EWHC 2436 (Comm).

National Westminster Bank Plc,[1032] the court rejected arguments that non-reliance and no-representation clauses are effectively exclusion clauses which are subject to section 3's reasonableness test. At first glance, these rulings could indicate a departure from the principles of fact-sensitive judicial review of defences based on contractual estoppel established in *Springwell*[1033] and *First Tower Trustees*.[1034] However, on closer analysis, it is evident that these principles are considered and applied in both cases, and the rejection of section 3 arguments results from the particular facts in each case. In fact, the decisions are not a retreat from, but rather consistent with, *First Tower Trustees*.[1035]

5.6 Conclusion

This chapter argues that tort law, specifically, the tort of deceit, the tort of negligence, including the tort of negligent misstatements, and the MA do not provide adequate protection to bank customers. They practically favour freedom of contract as much as the common law of contract, if not more, because there are no particular tort rules which interfere with freedom of contract, and certainly they promote it more than statutory consumer law. They also realistically take the same kind of paternalistic approach as the common law of contract and do so less than statutory consumer law and, logically, fail to provide the impure paternalism upheld in Chapter Two.

Indeed, the chapter highlights important problematic legal issues and inconsistencies in these torts and statute. The chapter essentially argues that a fraud claim requires thorough evidence, which is hard to attain, and is discovered after it is too late to intervene as the transaction will have been concluded. Banks do not owe a general tortious duty to exercise reasonable care and skill or a tortious general advisory duty to customers. Moreover, the MA also provides inadequate protection due to its convoluted drafting,

[1032] [2020] EWHC 3233 (Ch).
[1033] [2010] EWCA Civ 1221.
[1034] [2018] EWCA Civ 1396.
[1035] Gibaud and Holderness (n 1028).

especially in holding that banks making an innocent misrepresentation which induces customers to enter into a contract consequent to which the latter suffer loss are liable as if the misrepresentation was carried out fraudulently.

Hence, this chapter demonstrates that tort law and the MA fail to provide adequate protection to bank customers because they practically advocate freedom of contract more than the common law of contract and fail to furnish the type of impure paternalism proposed in Chapter Two. Additionally, tort law and the MA furnish no *ex ante* protection and limited *ex post* protection. The chapter further argues that although English courts may provide a degree of *ex post* protection, they are hesitant to hold banks liable under a tortious duty of care, to acknowledge that a bank has entered into an advisory relationship with a customer and/or find a bank liable at common law for providing no advice or negligent advice to a customer.[1036]

In fact, this is a possible reason why banks select English law to govern their contracts.[1037] In one recent case, the court even stated that a duty of care would not have been imposed even if it concluded that a recommendation had been furnished.[1038] The factual contexts of the cases wherein banks were found liable for the provision of negligent advice to customers were exceptional and involved a bank's agent or employee undertaking an advisory role outside the normal bank-customer relationship. Case law analysis demonstrates the difficulties customers experience to convince English courts that banks assumed an advisory role.[1039] Recent case law on financial mis-selling claims[1040] erects

[1036] Gregory Mitchell, 'To advise or not to advise?' (2014) 29(11) Journal of International Banking and Financial Law 686.
[1037] ibid.
[1038] *London Executive Aviation Ltd v The Royal Bank of Scotland plc* [2018] EWHC 74 (Ch).
[1039] ibid; *Box v Midland Bank Ltd* [1979] 2 LI Rep 391; *Williams & Glyn's Bank Ltd v Barnes* [1981] Com LR 205; *Cornish v Midland Bank plc* [1985] 3 All ER 513; *Lipkin Gorman v Karpnale Ltd* [1989] 1 WLR 1340; *Barclays Bank plc v Khaira* [1992] 1 WLR 623; *Lloyds Bank Plc v Cobb* (1991) 12 LDAB 210; *Verity and Spindler v Lloyds Bank plc* [1995] CLC 1557; *Bankers Trust International plc v PT Dharmala Sakti Sejahtera* [1996] CLC 518; *National Commercial Bank (Jamaica) Ltd v Hew's Executors* [2003] UKPC 51; Mitchell (n 1036).
[1040] *JP Morgan Chase v Springwell Corpn* [2008] EWHC 1186 (Comm); *Titan Steel Wheels Ltd v Royal Bank of Scotland plc* [2010] EWHC 211; *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB);

unjustified barriers in the way of customers who complain about their banks recommending unsuitable financial products to them.[1041] The scepticism with which certain judges have approached particular issues has converted the law into a desert of isolated cases.[1042] All the legal issues and difficulties discussed in this chapter result in unpredictable outcomes. The sole winner of this state of affairs is the bank. Furthermore, even when the court acknowledges that the bank has undertaken an advisory role, the claimant may only have a temporary victory because the contract terms may exclude liability.[1043]

Thus, this chapter further strengthens the overarching argument of the thesis that a synthesis of private law and financial regulation is necessary to form a coherent system of finance law which provides adequate bank customer protection.

O'Hare v Coutts [2016] EWHC 2224 (QB); *London Executive Aviation Ltd v The Royal Bank of Scotland plc* [2018] EWHC 74 (Ch).

[1041] Richard Edwards, 'Spot the Difference? "Investment advice" under FSMA and at common law' (2018) 10 Journal of International Banking and Financial Law 606; Richard Edwards, 'The liability of banks for negligent advice: time to go back to basics' (2019) 34(1) Journal of International Banking and Financial Law 3.

[1042] Edwards, 'The liability of banks for negligent advice: time to go back to basics' (n 1041).

[1043] *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch).

Chapter Six

The Limitations of Bank Customer Protection under the Regulatory Regime

6.1 Introduction

Pursuant to the Financial Services and Markets Act 2000 (FSMA), the United Kingdom's Financial Conduct Authority (FCA) is empowered to regulate and supervise banks' conduct of business and has a duty to ensure consumer protection.[1044] This chapter explores the extent to which the FCA's regulatory regime protects bank customers. It assesses inter alia whether financial regulation promotes freedom of contract and, if so, to what extent, or whether it provides the kind of impure paternalism which has been advocated in Chapter Two.

The chapter begins by discussing the components constituting the FCA's framework, essentially, the FCA's Handbook, the FCA's powers, consumer redress, the FCA's approach to protecting consumers, including vulnerable consumers, and the FCA's proposed new Consumer Duty. While discussing these elements, the chapter analyses the kind and extent of protection they provide and their strengths and weaknesses. Subsequently, the chapter argues that there are limitations of the FCA's regulatory regime. First, conduct of business regulation lacks coherence. Second, there is the possibility of regulatory arbitrage. Third, English courts limit the scope of financial regulation and refuse to recognise that it imposes private law obligations on banks. Fourth, a consumer protection gap, known as the advice gap, exists at the point at which the financial product and/or service is purchased, or sold, resulting in inadequate support for bank customers to engage with financial services. Fifth,

[1044] FCA, 'FCA Mission: Approach to Consumers' (July 2018) 12 <www.fca.org.uk/publication/corporate/approach-to-consumers.pdf> accessed 23 June 2022.

another consumer protection gap is present in relation to post-sale care. Finally, there is yet another consumer protection gap regarding welfare outcomes.

6.2 The Financial Conduct Authority's Regulatory and Legal Framework

The FCA is the conduct regulator in the UK and is responsible for conduct and relevant prudential regulation. It collaborates with the Prudential Regulation Authority, the prudential regulator.[1045] The FCA is autonomous from the government. It is funded through fees imposed on regulated firms.[1046] Under the FSMA, the FCA has one cardinal goal, namely, to ensure that financial markets work properly, and three underlying purposes to advance this: to ensure adequate consumer protection, the UK financial markets' integrity and efficient market competition favouring consumers' interests.[1047] These purposes are interlinked; ultimately, they proffer in preventing harm to consumers. Consequently, the FCA aims *inter alia* to ensure that banks are managed integrously, furnish adequate products and services to customers, do their utmost to satisfy their requirements and can be trusted.[1048]

6.2.1 The FCA Handbook

The FCA's regulation is contained in its Handbook[1049] and is primarily derived from relevant EU Directives.[1050] The FCA claims that its regulatory regime is outcome-

[1045] FCA, 'About the FCA' (22 November 2021) <www.fca.org.uk/about/the-fca> accessed 23 June 2022.
[1046] Ashley Kovas, *Understanding the financial conduct authority: a guide for senior managers* (Troubador Publishing Ltd 2015) 4; Tareq Na'el Al-Tawil and Hassan Younies, 'Corporate governance: on the crossroads of meta-regulation and social responsibility' (2020) 27(3) Journal of Financial Crime 801.
[1047] FSMA, s 1 B.
[1048] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 7.
[1049] FCA, 'FCA Handbook' <www.handbook.fca.org.uk/> accessed 23 June 2022.
[1050] eg Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU OJ L173/349; Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property and amending Directives 2008/48/EC and 2013/36/EU and Regulation (EU) No 1093/2010 OJ L60/34.

driven and consists of a mix of high-level Principles for Businesses (Principles) and rules, as well as, where necessary, comprehensive rules and guidelines.[1051] When dealing with consumers, banks must primarily comply with the Principles and the rules laid out in the Conduct of Business Sourcebook (COBS), Banking Conduct of Business Sourcebook (BCOBS), Consumer Credit Sourcebook (CONC), and Mortgages and Home Finance Conduct of Business Sourcebook (MCOB). These are discussed hereunder.

6.2.1.1 Principles

The FCA's precepts are founded on eleven Principles.[1052] They provide an overarching framework for governing banks' behaviour.[1053] In fact, they establish wider standards than the more detailed COBS rules.[1054] All the regulatory rules must be interpreted by reference to these Principles.[1055] In dealing with customers, banks must conduct their business with integrity[1056] and with proper skill, care and diligence;[1057] take reasonable care to arrange and handle their activities accountably and efficiently, implementing proper risk management processes;[1058] pay attention to their customers' interests and deal fairly with them;[1059] pay attention to their customers' information requirements and provide information in a clear, fair and non-misleading manner;[1060] handle fairly any conflicts of interest;[1061] furnish suitable advice and discretionary judgments to the relevant customers;[1062] and provide appropriate customer asset protection where applicable.[1063]

[1051] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 12-13.
[1052] FCA Handbook, PRIN.
[1053] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 12.
[1054] Martin Berkeley, 'Do the FCA's Principles for Business require a firm to give the best advice?' (2018) 33(4) Journal of International Banking and Financial Law 246.
[1055] Alastair Hudson, *The Law of Finance* (2nd edn, Sweet and Maxwell 2013) paras 9-02, 9-33.
[1056] FCA Handbook, PRIN 2.1.1, Principle 1.
[1057] ibid PRIN 2.1.1, Principle 2.
[1058] ibid PRIN 2.1.1, Principle 3.
[1059] ibid PRIN 2.1.1, Principle 6.
[1060] ibid PRIN 2.1.1, Principle 7.
[1061] ibid PRIN 2.1.1, Principle 8.
[1062] ibid PRIN 2.1.1, Principle 9.
[1063] ibid PRIN 2.1.1, Principle 10.

The FCA also publishes guidance containing information and advice to support these Principles. For instance, the FCA issued guidelines containing six customer outcomes that sustain Principle 6.[1064] These outcomes establish the FCA's anticipations on the manner banks should deal with their customers, including vulnerable ones,[1065] and the FCA uses such outcomes to assess banks' conduct.[1066]

Notably, Principles' breaches make banks liable to FCA disciplinary action[1067] but they are not actionable under section 138D of the FSMA. Therefore, the Principles are enforceable at the level of the bank-regulator relationship and do not furnish direct redress to bank customers. Consequently, it is argued that, notwithstanding the wide legal framework, *ex post* review of banks' behaviour has yielded little in practice. Hence, *ex post* revision of bank contracts is surely arduous. Customers have practically no guarantee that banks will assist them if their requirements and circumstances change post-sale, and need the bank contract to be dramatically adjusted.[1068]

It is argued that it is illogic to restrict section 138D applicability in this manner. Extending the provision to include the Principles is recommendable as it would grant bank customers a right to sue for breaches thereof independently of a contractual relationship. It is further argued that such an extension is all the more reasonable given that the provision's presumable aim is to protect the vulnerable customers from unfair or adverse conduct committed by the more sophisticated banks.[1069]

[1064] FCA, 'Fair treatment of customers' (24 March 2021) <www.fca.org.uk/firms/fair-treatment-customers> accessed 23 June 2022.
[1065] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (February 2021) para 1.23 <www.fca.org.uk/publication/finalised-guidance/fg21-1.pdf> accessed 23 June 2022.
[1066] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 13.
[1067] FCA Handbook, PRIN 1.1.7G.
[1068] Iris H-Y Chiu, Andreas Kokkinis and Andrea Miglionico, 'Addressing the challenges of post-pandemic debt management in the consumer and SME sectors: a proposal for the roles of UK financial regulators' (2 October 2021) Journal of Banking Regulation <https://doi.org/10.1057/s41261-021-00180-2> accessed 23 June 2022.
[1069] Stevie Loughrey and Charles Enderby Smith, 'Banking litigation: a changing landscape?' (2015) 30(9) Journal of International Banking and Financial Law 563.

6.2.1.2 COBS

COBS rules are significant as they bind banks to positive duties.[1070] They include such matters as customers' best interests,[1071] communications with customers,[1072] financial promotions,[1073] suitability[1074] and appropriateness[1075] of investments for customers, and record keeping.[1076] The COBS provisions and remaining FCA Handbook are backed up by a broad prohibition on efforts to limit or impede their implementation.[1077] According to COBS 2.1.2R, in any correspondence regarding designated investment business, banks must not endeavour to exempt or limit, or count on any elimination or limitation of, any obligation or liability they may owe to customers under the regulatory regime. COBS rules' breaches are actionable under section 138D(2) of FSMA by customers if they have suffered loss consequent to the breach. As will be noted, COBS rules provide primarily *ex ante* protection, imposing obligations on banks mainly at point of sale.

6.2.1.2.1 Customer's best interests

It is claimed that, within the FCA Handbook, the COBS rules represent the biggest hurdle for banks[1078] given that COBS 2.1.1R(1) sets 'the client's best interests rule'. This rule provides that a 'firm must act honestly, fairly and professionally in accordance with the best interests of its client'. However, that said, it is argued that, notwithstanding that this rule is broadly phrased, bank customers have a significant burden in proving banks' breach thereof. Moreover, this rule is solely applicable to 'designated investment business'.[1079] Therefore, it is inapplicable in the case of the sale of a savings account or a mortgage. Hence, for example, banks are not obliged

[1070] Hudson (n 1055) para 10-16.
[1071] FCA Handbook, COBS R 2.1R.
[1072] FCA Handbook, COBS 4.2R.
[1073] FCA Handbook, COBS 4.2R.3R.
[1074] FCA Handbook, COBS 9, 9A.
[1075] FCA Handbook, COBS 10, 10A.
[1076] FCA Handbook, COBS 9.5, 9A.4, 10.7, 10A.7.
[1077] Keith Stanton, 'Investment advice: The statutory remedy' **(**2017) 33(2) Journal of Professional Negligence 153.
[1078] Hudson (n 1055) para 9-43.
[1079] FCA Handbook, COBS 2.1.1R(2).

to advise customers on a more advantageous interest rate obtainable from another bank. *Caveat emptor* is allowed in these instances.[1080]

In this regard, in *MTR Bailey Trading Limited v Barclays Bank* plc,[1081] the claimant contended that the bank infringed the rule as it had required it to transfer a disadvantageous swaps contract to an associated company. The court at first instance held that a bank's mere mistake regarding its contractual rights did not constitute an infringement of the best interests' rule.[1082] Yet, the claimant was allowed to challenge the judgment by the Court of Appeal, noting that the company's argument was plausible.[1083] It has been claimed that the first-instance judgment was right.[1084] It is counter argued that, however, the Court of Appeal's interpretation is actually correct as the bank had a duty to act in the company's best interests and, hence, it was obliged to be cautious and refrain from making such a detrimental error.

6.2.1.2.2 Provision of information and communication with the bank customer

Crucial provisions dictate the type of information delivered to bank customers. COBS 2.2.1R obliges banks to provide general pre-contractual information to their customers. It goes beyond the analogous common law duty to not furnish misleading information[1085] because it obliges banks to provide information on themselves, their charges as well as the associated risks with the investment strategy or the selected investments recommended.[1086] After banks establish a relationship with customers, they must comply with more detailed rules. COBS 4.2.1R emphasises the importance of fair, unambiguous and non-misleading communications and financial promotions. The rule is intended to guarantee that banks provide customers with a fair view of the

[1080] Keith Stanton, 'Investment advice: The statutory remedy' (2017) 33(2) Journal of Professional Negligence PN 153.
[1081] [2014] EWHC 2882 (QB).
[1082] ibid.
[1083] *MTR Bailey Trading Limited v Barclays Bank* plc [2015] EWCA Civ 667.
[1084] Keith Stanton, 'Investment advice: The statutory remedy' (2017) 33(2) Journal of Professional Negligence PN 153.
[1085] *Green & Rowley v The Royal Bank of Scotland plc* [2013] EWCA Civ 1197, [17].
[1086] *Sulaiman v Credit Suisse Securities (Europe) Ltd* [2013] EWHC 400 (Comm), [154]; Stanton (n 1084).

benefits and hazards of a potential investment.[1087] Effectively, it establishes a statutory redress for misrepresentation. The court found in *Rubenstein v HSBC Bank PLC*[1088] that advice stating that an investment was as 'safe as cash' when it was actually equity-based was litigable.[1089] Unlike COBS 2.2.1R, tort actions for COBS 4.2.1R infringement require evidence of negligence because banks can defend themselves by demonstrating that they undertook reasonable measures to ensure compliance.[1090]

6.2.1.2.3 Suitability

Banks must undertake reasonable measures to ascertain that a product's personal recommendation or a trading decision is suitable for their customers. Such criteria as the customer's risk appetite, knowledge, experience, financial position, investment aims and loss capacity must be considered.[1091] Recommendation is held to be investment advice.[1092] A crucial distinction is made between advised and non-advised transactions.[1093] The suitability requirement does not apply to a product's sale that is independent of an advising or managerial activity, or, unless particular products are proposed, general advice on tax, investments or estate planning.[1094] *Caveat emptor* and the law of negligence govern such transactions. The differentiation is particularly important to banks because they frequently provide both services to their customers. Moreover, banks provide non-advisory online investment services to private customers. Investment products purchased in this manner are exempt from the suitability requirement.[1095]

Alleged breaches of the suitability requirement[1096] have formed the ground of most cases instituted under section 138D(2).[1097] The provision establishes a strict liability

[1087] Stanton (n 1077).
[1088] [2012] EWCA Civ 1184.
[1089] see *Worthing v Lloyds Bank plc* [2015] EWHC 2836, [63].
[1090] FCA Handbook, COBS 4.2.6R.
[1091] FCA Handbook, COBS 9.2.1R, COBS 9A.2.1.
[1092] ibid. Stanton (n 1077).
[1093] *JP Morgan Chase Bank v Springwell Navigation Corpn* [2008] EWHC 1186 (Comm).
[1094] See FCA Handbook, PERG 2.7.15G
[1095] Stanton (n 1077).
[1096] FCA Handbook, COBS 9.
[1097] Stanton (n 1077).

result, being independent of any element of negligence. It is argued that the provision is concerned with the end result rather than the means used for the achievement thereof.[1098] In *Zaki v Credit Suisse (UK) Ltd*,[1099] the court held that if a suitable product was proposed, despite procedural flaws developed in the procedure which led to such proposal, there was no actionable breach of such obligation.[1100]

In the cardinal case *Rubenstein v HSBC Bank plc*,[1101] the Court of Appeal considered the relationship between the extent of a financial advisor's obligation to discern and assess a proposed investment's risk, and the advisor's legal duty for loss suffered by the customer, who trusted the proposal. The omission to carry out a fact find and the advice of an improper investment given the customer's risk appetite were both grounds for liability. Lack of suitability was grounded on the fact that a safer product was available, which product would have been more suitable for the customer in view of their risk appetite. However, it has been claimed that an investment which, with hindsight, can be demonstrated to have been a wrong one, does not necessarily imply that it was unsuitable when it was effected.[1102] Further, when banks provide investment advice, both the investment itself and the advice must be suitable.[1103] In *Morgan Stanley UK Group v Puglisi Cosentino*,[1104] the court considered suitability to be a double-edged concept.

It is argued that the suitability duty is restricted in two main ways in relation to customers. First, the duty is targeted at a product's suitability. This means that banks may not necessarily have conducted thorough market research and chosen the best available product. Banks acting as independent advisors are obliged to execute a strategy to search the market properly. However, such an obligation is phrased procedurally rather than substantively. This raises issues on the manner a challenge

[1098] ibid.
[1099] *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14, [129].
[1100] Stanton (n 1077).
[1101] [2012] EWCA Civ 1184.
[1102] See *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14; *O'Hare v Coutts & Co* [2016] EWHC 2224 (QB).
[1103] Berkeley (n 1054).
[1104] [1998] CLC 481 QBD (Comm).

for a suboptimal option is construed in court.[1105] Secondly, although reforms have been introduced to forbid banks as advisers to receive commissions[1106] except in restricted instances,[1107] such reforms resulted in adverse consequences in the advice market to consumers' detriment.[1108]

Interestingly, it has been argued that, despite the Principles do not explicitly state the client's best interests obligation, certain Principles could be interpreted to have such concept as an intrinsic element. These include the duties to act with integrity, exercise skill, care and diligence and consider customers' interests. The best interests' obligation is clearly mentioned in COBS 2.1.1 R. It has been contended that this seemingly absence of clarity should be viewed in light of the FCA's objective in the Principles, with the COBS rules effectively elaborating on them.[1109] Further, the Principles are supreme to the COBS rules. In *British Bankers Association v Financial Services Authority*[1110] the court held that the Principles are 'the ever-present substrata to which the specific rules are added', 'stand over the specific rules' and are an 'overarching requirement which cannot be displaced by compliance with specific rules if the overarching requirement is breached'.[1111] It is therefore arguable that the implication of the Principles' supremacy indirectly requires banks to provide the best advice and most suitable product to act in customers' best interests.[1112]

6.2.1.2.4 Appropriateness

While COBS 9 imposes a suitability requirement, COBS 10 creates an appropriateness one, which simply requires banks to obtain information on the customer's knowledge and experience of the investment under consideration and its

[1105] Iris H-Y Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (2021) 41(4) Legal Studies 657.
[1106] FCA Handbook COBS 6.1A.
[1107] ibid, at COBS 6.1A.1A–2A.
[1108] Chiu (n 1105).
[1109] Berkeley (n 1054).
[1110] [2011] EWHC 999 (Admin).
[1111] ibid 162-166.
[1112] Berkeley (n 1054).

inherent risks.[1113] COBS 10 is much less onerous because it does not impose the obligation to identify the customer's means and investment intentions.[1114] Thus, COBS 10 generates a distinct obligation when customers purchase complicated products without advice. This rule's objective is to provide buyers of such products as options, derivatives and swaps with a certain degree of protection. When a scenario falls under COBS 10, banks must examine whether the product is appropriate for the customer[1115] and alert them if it is not.[1116] Whereas the suitability requirement protects customers who have been poorly advised, the appropriateness requirement protects those who are unaware of what they are doing.[1117]

It is claimed that COBS 10 performs an important function in protecting customers because it has severely restricted the instances when banks may deal with customers truly at arm's length, that is, in an execution-only situation. Moreover, it provides minimum regulatory protection in non-advised transactions as it tilted the balance to favour customers since banks may not act entirely in their own interests and for their own advantage. Rather, they must take cognisance of customers' interests by screening the proposed product or service for appropriateness. Although the obligations in COBS 10 are far less wide ranging and rigorous than those in COBS 9, they can be a useful tool in holding banks to account for losses caused by inappropriate products or services sold to customers.[1118]

It has been argued that a bank which has sold an inappropriate product to a retail customer has sold that customer a product which no bank should have ever sold to this group of retail customers. This is not an error of judgment by an individual banker but a failure of the bank's systems and controls. Thus, it is argued that it would be just to oblige banks to owe a common law duty to exercise reasonable skill and care not

[1113] FCA Handbook, COBS 10.2.1R.
[1114] Stanton (n 1077).
[1115] FCA Handbook, COBS 10.2.1R.
[1116] FCA Handbook, COBS 10.3.1R
[1117] David McIlroy and Susanne Muth, 'COBS 10: the dog that doesn't bark?' (2019) 34(4) Journal of International Banking and Financial Law 252.
[1118] ibid.

to sell inappropriate products to customers. Such a duty would not be onerous but merely establish a clear baseline of customer protection.[1119]

Furthermore, it appears that the COBS rules are being interpreted and implemented in an inconsistent manner. When banks sell products on a non-advised basis, banks may believe they have complied with the rules vis-à-vis the appropriateness test. Since various financial products may be satisfactory, it is unclear how this ought to be reconciled with the Principles, which indirectly require banks to act in customers' best interests at all times, that is, in both advised and non-advised sales. It is therefore arguable that compliance with the appropriateness requirement is insufficient under the Principles. For many customers, the COBS rules provide an opportunity for redress when they are sold a product which is not the best or most suitable. However, as previously indicated, COBS does not explicitly specify the best interests rule for non-advised sales.[1120] This potentially implies that the COBS rules are deficient unless a claim invoking the Principles' supremacy can be made as per *BBA v FSA*.[1121]

6.2.1.2.5 Advice or information

Given the broad repercussions of a determination that a transaction was 'advised' and not 'execution-only', the differentiation between providing information and advice to customers is crucial. When a COBS rule is breached, it could result in a claim in negligence and/or breach of a statutory duty pursuant to section 138D(2) of FSMA, provided the latter is applicable to the breached rule. Moreover, banks as advisers owe common law and/or contractual duties to customers.[1122] Therefore, a breach of the duty to advise could trigger a claim for breach of statutory duty under section 138D(2) of FSMA and/or a claim in negligence and/or a claim for breach of a contractual duty.

[1119] ibid (n 1117).
[1120] Berkeley (n 1054).
[1121] [2011] EWHC 999 (Admin); Berkeley (n 1054).
[1122] Andrew Davies, 'Information or advice: the value judgment' (2015) 30(11) Journal of International Banking and Financial Law 693.

The FCA has idenitifed an expectations gap in connection to this critical distinction, namely, the discrepancy between firms' comprehension of what is of expected of them by the FCA and the latter's actual expectations of firms.[1123] It is claimed that the FCA takes a cautious view on retail investment advice.[1124] The FCA argues that the distinction between advice and mere information is the advisor's feature of the decision or opinion, whether face-to-face or, for instance, online. Advice entails the recommendation of a plan of action or the taking of a decision on whether to exercise a right, for instance, to purchase or sell. Ordinarily, providing information, without any comment or value judgment, does not involve giving advice. Hence, conveying facts on investment performance, investment contract clauses and conditions, or investment price does not constitute advice when customers are free to choose their own course of action. Yet, providing information, which is selective and not impartial, to influence or convince, may be considered advice. Both the facts and context of the case should be examined to determine whether anything is advice or not.[1125]

In the domain of direct-to-customer trading platforms and digital information services, it is debatable whether, what could otherwise be considered as the supply of information on market movements, share prices, or acts of other market players, is deemed advice since it assumes a recommendation's characteristics under the circumstances. Given the inherent contradiction between the goal to foster innovation and the drive to reduce costs in the retail investment market, as well as the FCA's and courts' cautionary approach to such delicate matters, it is likely that it will continue to be contentious.[1126]

[1123] FCA, 'Finalised Guidance: FG17/8 Streamlined advice and related consolidated guidance' (September 2017) <www.fca.org.uk/publication/finalised-guidance/fg-17-08.pdf> accessed 23 June 2022.
[1124] Andrew Davies, 'Information or advice: the value judgment' (2015) 30(11) Journal of International Banking and Financial Law 693.
[1125] FCA, 'Finalised Guidance: FG17/8 Streamlined advice and related consolidated guidance' (n 1123).
[1126] Davies (n 1124).

6.2.1.3 BCOBS

BCOBS is a sourcebook that applies primarily to the service of accepting customers' deposits in the UK. However, certain provisions are also applicable to payment and electronic money services.[1127] BCOBS strengthens the requirements of Principle 6's obligation to consider customers' interests and treat them fairly, as well as Principle 7's requirement to consider customers' information needs and present information to them in a clear, fair and non-misleading way.[1128] Hence, as a result of COBS, the FCA Handbook framework is essentially applicable to banks and typical bank activities. This is noteworthy since traditional banking had formerly received less regulatory attention than investment activity.[1129]

It is argued that BCOBS furnishes mainly *ex ante* protection as, essentially, it incorporates rules and guidelines on adequate communication with customers, including financial promotions[1130] and distance communication,[1131] to enable them to make informed decisions.[1132] It provides a certain degree of *ex post* protection because it imposes obligations on banks to provide account statements;[1133] post-sale duties to provide proper service to assist customers transfer accounts to another bank, or to assist them in accessing lost and dormant accounts; obligations to refund customers for unapproved and wrongly effected payments;[1134] and duties regarding the possibility of cancellation of contracts for banking services in certain circumstances.[1135]

[1127] FCA Handbook, BCOBS 1.1
[1128] FCA Handbook, BCOBS 2.1.
[1129] Hudson (n 1055) para 31-14.
[1130] FCA Handbook, BCOBS 2.1-2.4.
[1131] FCA Handbook, BCOBS 3.1-3.2.
[1132] FCA Handbook, BCOBS 4.1.
[1133] FCA Handbook, BCOBS 4.2.
[1134] FCA Handbook, BCOBS 5.1.
[1135] FCA Handbook, BCOBS 6.1-6.4.

6.2.1.4 CONC

The CONC applies to activities regarding consumer credit, for instance, for instance, overdrafts, credit cards, payday lending, personal loans and mortgages.80[1136] Most rules were carried across from then existing conduct-related provisions in the CCA and secondary legislation.[1137] CONC rules provide *ex ante* protection for customers by establishing rules on financial promotions, pre-contractual disclosure and primarily by obliging banks to comply with responsible lending, ensuring that customers afford the loans granted.[1138] Regarding unsecured consumer credit, with the exception of overdrafts, stringent responsible lending provisions require banks to conduct a rational analysis of customers' financial health prior to concluding a regulated credit contract or enhancing the credit amount or limit substantially pursuant to such a contract. The qualities that banks must consider comprise customers' savings, other property, earnings and general financial position.[1139] CONC furnishes some *ex post* protection given its rules on arrears, default and recovery, including repossession. Further, banks must treat customers in arrears with due consideration and tolerance, and have robust policies in place to handle adequately customers whose accounts fall into arrears, particularly where such customers are vulnerable.[1140]

6.2.1.5 MCOB

The MCOB provisions apply to home finance activities,[1141] namely, regulated mortgage contracts, equity release transactions – comprising lifetime mortgages as well as home reversion plans – home purchase plans and regulated sale and rent back agreements.[1142] MCOB also compels banks to behave in an honest, fair and

[1136] see Andreas Kokkinis and Andrea Miglionico, *Banking Law: Private Transactions and Regulatory Frameworks* (Routledge 2021) chs 5.2, 6, and 9.4.
[1137] Peter Snowdon and Anushka Herath, 'Countdown to the New Regime: Transfer of Consumer Credit Regulation' (2013) 11 Journal of International Banking and Financial Law 723.
[1138] ibid; Chiu, Kokkinis and Miglionico (n 1068).
[1139] FCA Handbook, CONC Rule 5.2A.4.
[1140] FCA Handbook, CONC Rule 7.2.1.
[1141] FCA Handbook, MCOB 1.2.1R.
[1142] FCA Handbook, MCOB 1.2.2R.

professional manner in customers' best interests.[1143] It has been argued that, in contrast to the Mortgage Credit Directive,[1144] the 'best interests' duty is applicable to the whole process, that is, promoting, advising, selling, servicing and enforcement and not only to advice services.[1145]

It has been contended that the rationale for the duty to operate in customers' best interests when providing advice is comprehensible. Banks must aim to achieve the best outcome for customers and avoid conflicts of interests that could jeopardise their wellbeing. However, in relation to mortgages, banks' main aim is to earn from money lending, primarily through interests, and not furnishing advisory and ancillary services. It has been argued that, while the 'best interests' duty is vital for mortgage advising service, the reasoning behind a general 'best interests' rule is relatively very weak and totally inapplicable to core lending because the relationship is diverse and a multitude of rules, including treating customers fairly, already safeguard customers.[1146]

It has been claimed that, supposing that the 'best interests' criterion is more than a re-enactment of the 'treating customers fairly' rule and imposes an entirely new standard, it is questionable what it expects of banks.[1147] The status of the 'treating customers fairly' rule was confirmed in *BBA v FSA*.[1148] The court held that although firms complied with all specific rules, they failed to adhere to this rule. According to the court, this rule was an independent and overriding concept and not the consequence of adherence to the other regulatory rules.[1149] Hence, it has been argued that, despite banks follow the MCOB and 'treating customers fairly' rules, the FCA may nevertheless conclude that they have not acted in customers' best interests. It has been further contended that the MCOB 'best interests' rule should be regarded as akin to the Mortgage Credit

[1143] FCA Handbook, MCOB 2.5A.1R.
[1144] Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property [2014] OJ L60/34.
[1145] See Directive 2014/17/EU of the European Parliament and of the Council of 4 February 2014 on credit agreements for consumers relating to residential immovable property [2014] OJ L60/34, art 7; Roger Tym and Elizabeth Greaves, 'The new MCOB "best interests" rule for residential mortgages: is it fair?' (2015) 30(3) Journal of International Banking and Financial Law 160.
[1146] Tym and Greaves (n1145).
[1147] ibid.
[1148] [2011] EWHC 999 (Admin).
[1149] ibid.

Directive rule and that banks acting honestly, fairly and professionally will be acting in customers' best interests. It has been suggested that the FCA could furnish guidance to establish the extent of the 'best interests' requirement.[1150]

In this context, it is argued that the 'best interests' rule should indeed apply to core lending and considered to be more onerous than the 'treating customers fairly' rule. While it is recognised that banks' aim in core lending is to earn money, they must nonetheless consider customers' interests and have regard to their financial welfare. Like CONC, MCOB contains rules which dictate the factors that banks must consider prior to carrying out transactions. The MCOB rules provide that banks can only enter into mortgage contracts with customers if they can prove that the customer affords the mortgage contract.[1151] Banks' affordability assessments are grounded on the customer's net income, deducting all types of expenditure, including income tax, national insurance, personal and family commitments and any other expenses.[1152] The stated income must be proven from independent sources; customer's self-certification is insufficient.[1153]

It is argued that the FCA's affordability framework assists in overcoming customers' folly and financial illiteracy by exposing banks and customers to a simple and impartial computing exercise. However, it also makes general economic assumptions concerning customers' financial profiles and needs. It is further claimed that the affordability assessment establishes a compromise; it permits the consumer credit market to expand with no overly restriction of credit supply. Customer choice enhancement goes hand in hand with abstention of the imposition of too stringent duties on banks. Furthermore, the simple affordability test aligns with prudential regulation's aim to manage credit risk.[1154] Thus, it is argued that the current consumer credit framework requires the 'best interests' rule to apply to core lending. The present framework provides only limited *ex ante* protection to customers, concentrating on

[1150] Tym and Greaves (n 1145).
[1151] FCA Handbook, MCOB 11.6.2(1)(b).
[1152] FCA Handbook, MCOB 11.6.5.
[1153] FCA Handbook, MCOB 11.6.8.
[1154] Chiu, Kokkinis and Miglionico (n 1068).

contract conclusion stage. There is no assistance to customers in any *ex post* debt challenges.[1155]

A case in point is the fact that the mortgage deed may expedite the term during which the mortgagee may exercise their enforcement powers. In *UBS AG v Rose Capital Ventures Ltd*,[1156], the court stated that the mortgagee is not allowed to call in the loan unless there are decent reasons. According to the court, the mortgagee will not contempt their obligation of good faith or a *Braganza* term[1157] if they utilise such rights for an appropriate purpose rather than to vex the mortgagor.[1158] Thus, it appears that the ultimate test of whether a mortgagee has acted properly is whether they have exercised their rights in good faith.[1159] It is argued that the FCA's *ex ante* protection regime is of limited use to customers in such circumstances.

6.2.2 The FCA's Powers

The FCA's powers under FSMA provide some degree of *ex ante* protection as the FCA may set rules applicable to both banks' regulated and unregulated activities.[1160] Although the FCA's primary focus is regulated activities, a bank's unregulated activities may be pertinent and the FCA may act or forward concerns to other relevant authorities.[1161] It also publishes guidance containing information and advice relating to various matters, such as FSMA, the FCA's Handbook rules and its functions.[1162] For instance, it has been submitted that the UK legislation's application to vary a contract term is a particular concern to firms. The FCA's related guidance, published in December 2018, was held to have clarified its position on this challenging matter.[1163]

[1155] ibid.
[1156] *UBS AG v Rose Capital Ventures Ltd* [2018] EWHC 3137 (Ch).
[1157] The Braganza term originated in the Supreme Court's decision in *Braganza v BP Shipping Ltd* [2015] 1 WLR 1661, which concerned a death in service payment clause in an employment contract.
[1158] *UBS AG v Rose Capital Ventures Ltd* [2018] EWHC 3137 (Ch) [57].
[1159] Dennis Rosenthal, 'The scope of a mortgagee's implied rights' (2020) 35(2) Journal of International Banking and Financial Law 124.
[1160] FSMA section 137A.
[1161] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 12.
[1162] ibid 13.
[1163] Malcolm Waters, 'New guidance from the FCA on the fairness of variation terms in consumer contracts' (2019) 34(3) Journal of International Banking and Financial Law 170.

The FCA's other powers under different laws also provide certain *ex post* protection. Under the Enterprise Act 2002 and concurrently with the Competition and Markets Authority (CMA), the FCA has the authority to assess whether the banking industry is functioning properly. Its authority extends further than the activities that it currently regulates. It may request information and submit an inquiry to the CMA to conduct a more thorough investigation. Moreover, the FCA may conduct investigations and enforcement against any infraction of the Competition Act 1998, and coordinates with the CMA to determine which authority should take action. In the end, the CMA has the final say.[1164]

Under general consumer law, the FCA has authority to safeguard consumers from harm.[1165] The FCA is a regulatory body and a qualifying one in terms of the Consumer Rights Act 2015 (CRA 2015) and the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR 1999) respectively.[1166] Pursuant to the CRA 2015 and other statutes, for instance, the Enterprise Act 2002, the FCA may enforce violations of consumer protection laws. It may assess whether banks' contract terms are fair and substantially prejudice consumers, in contrast to the good faith requisite.[1167] Furthermore, pursuant to the CRA 2015 and UTCCR 1999, the FCA may ban any unfair banks' practices at any stage of a transaction. Additionally, it considers contract law in a broader sense, such as contracts' enforceability and vulnerable consumers' capability of entering into contracts.[1168] The FCA may investigate complaints and act against banks. It may either seek an injunction to prevent reliance on an unfair or non-transparent term or obtain a commitment.[1169] The FCA again coordinates its work with the CMA, which is in charge in the enforcement of the CRA 2015 and UTCCR 1999.[1170]

[1164] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 14.
[1165] ibid.
[1166] FCA, 'Finalised guidance FG18/7: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015 (19 December 2018) para 1 <www.fca.org.uk/publication/finalised-guidance/fg18-07.pdf> accessed 23 June 2022.
[1167] Consumer Rights Act, Part 2.
[1168] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 14.
[1169] FCA, 'Finalised Guidance: FG18/7: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015' (n 1166) para 5; FCA Handbook, 'The Unfair Contract Terms Regulatory Guide' (June 2022) s 1.3.4 G <www.handbook.fca.org.uk/handbook/UNFCOG.pdf> accessed 23 June 2022.
[1170] FCA, 'Unfair contract terms' (6 January 2021) <www.fca.org.uk/firms/unfair-contract-terms> accessed 23 June 2022; FCA, 'Finalised Guidance: FG18/7: Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015' (n 1166) para 7.

Moreover, the FCA may act under the FSMA 2000 to protect consumers when it is concerned on a contract term, in addition to its authority in terms of the CRA 2015 and UTCCR 1999.[1171] Yet, the FCA is aware that only a court can ultimately determine on the fairness or otherwise of a term as per the CRA 2015 or UTCCR 1999, and, hence, cannot approve terms.[1172] Additionally, pursuant to the Equality Act 2010, the Public Sector Equality Duty[1173] obliges the FCA to take cognisance of the requirement to end discrimination, and promote equality of opportunity and good relationships among consumers with or without a protected feature. This includes contemplating any effect on consumers' capability of accessing banking services.[1174]

6.2.2.1 FCA's reliance on credible deterrence

Ultimately, the FCA's powers form part of a coercive-regulatory function[1175] based on credible deterrence, which is vital to banks' conduct reform. Most of the FCA's activities in executing its statutory obligations as a financial services regulator,[1176] including its enforcement work, is grounded on credible deterrence.[1177] To this end, the FCA has various enforcement criminal, civil and regulatory powers to safeguard consumers and hold banks and individuals accountable for failing to achieve the standard requirements.[1178] The FCA may impose financial penalties, cancel banks' authorisations and place restrictions on individuals.[1179] Additionally, it publishes enforcement notices to keep the public informed and their determinations transparent, and optimise deterrence.[1180] However, regulatory enforcement does not effectuate

[1171] FCA, 'Unfair contract terms' (n 1170).
[1172] FCA, 'Finalised Guidance: FG18/7 Fairness of variation terms in financial services consumer contracts under the Consumer Rights Act 2015' (n 1166) para 3; FCA, 'Getting firms to change or delete unfair contract terms' (25 June 2018) <www.fca.org.uk/firms/unfair-contract-terms/change-delete-unfair-contract-terms> accessed 23 June 2022.
[1173] Equality Act 2010, s 149.
[1174] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 14.
[1175] Hudson (n 1055) para 3-04.
[1176] Gary Wilson and Sarah Wilson, 'The FSA, "credible deterrence", and criminal enforcement – a "haphazard pursuit"?' (2014) 21(1) Journal of Financial Crime 4.
[1177] FCA, 'Enforcement and credible deterrence in the FCA' June 2013 <www.fca.org.uk/publication/news/enforcement-credible-deterrence-speech.pdf> accessed 23 June 2022; Shazeeda Ali, 'Fighting financial crime: failure is not an option' (2020) 27(1) Journal of Financial Crime 1.
[1178] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 20.
[1179] Wilson and Wilson (n 1176).
[1180] Ali (n 1177).

compensation for consumers.[1181] Banks may file a claim in the Upper Tribunal, Tax and Chancery Chamber, to appeal against FCA's decisions.[1182]

The penalty regime has been claimed to be a significant mechanism for handling small violations of financial industry protection laws.[1183] However, it is arguable that, if compliance is cumbersome or has a negative impact on profitability, banks consider a penalty and the subsequent small reputational harm simply a cost of conducting business. This is evidenced by banks' behaviour, which demonstrates a shocking disrespect for their regulatory responsibilities. Banks treat regulatory compliance as an expense rather than a matter of positivist law.[1184] It is further arguable that a 'naming and shaming' policy would be ineffectual when everybody would be listed and disgraced.[1185] In fact, it has been claimed that public's loss of confidence in banks is more closely associated with public perception that banks regard the price of misconduct as an ordinary business expense. It has been further suggested that while penalties affect bank shareholders, bankers do not face any risk except possibly a reduced compensation.[1186] The problem is exemplified by the PPI,[1187] LIBOR rigging[1188] and Lloyds/HBOS Reading scandal,[1189] and Royal Bank of Scotland plc's customers' treatment in their transfer to its Global Restructuring Group.[1190]

[1181] Iris H-Y Chiu, 'Book Reviews: Principles of Financial Regulation' (2017) 80(6) Modern Law Review 1193.
[1182] 'Upper Tribunal (Tax and Chancery Chamber)' <www.gov.uk/courts-tribunals/upper-tribunal-tax-and-chancery-chamber> accessed 23 June 2022.
[1183] Ali (n 1177).
[1184] Hudson (n 1055) para 3-04.
[1185] John Kay, *Other People's Money: Masters of the Universe or Servants of The People* (Profile Books Ltd 2017) 161.
[1186] Paul Marshall, 'English judges prefer bankers to nuns: changing ethics and the Plover bird' (2019) 34(8) Journal of International Banking and Financial Law 505.
[1187] FCA, 'Lloyds Banking Group fined £117m for failing to handle PPI complaints fairly (5 June 2015) <www.fca.org.uk/news/press-releases/lloyds-banking-group-fined-%C2%A3117m-failing-handle-ppi-complaints-fairly> accessed 23 June 2022.
[1188] Liam Vaughan and Gavin Finch, 'LIBOR Lies Revealed in Rigging of $300 Trillion Benchmark' (*Bloomberg*, 6 February 2013) <www.bloomberg.com/news/articles/2013-01-28/libor-lies-revealed-in-rigging-of-300-trillion-benchmark> accessed 23 June 2022
[1189] Mark Kleinman, 'HBOS Reading victims to be offered £3m compensation in bid to break logjam (13 June 2022) <https://news.sky.com/story/hbos-reading-victims-to-be-offered-3m-compensation-in-bid-to-break-logjam-12632968#:~:text=The%20HBOS%20Reading%20scandal%20has,during%20the%202008%20banking%20crisis.> accessed 23 June 2022.
[1190] FCA, 'Report on the Financial Conduct Authority's further investigative steps in relation to RBS GRG' (June 2019) <www.fca.org.uk/publication/corporate/fca-report-further-investigation-rbs-grg.pdf.> accessed 23 June 2022.

It has been argued that, where banks fail to satisfy the standard requirements and either execute or assist a financial crime, the FCA should act to not solely penalise them but also to dissuade others from acting similarly. Hence, it is claimed that the FCA should not hesitate to invoke its powers to suspend or revoke banks' authorisations. This would achieve sanctions' typical penal and preventative goals, while also promoting banking industry trust and lowering financial crime risk.[1191]

6.2.2.2 The FCA's main supervisory principles

It is contended that the FCA's supervisory principles, which underlie its supervisory methodology and complement the Principles,[1192] essentially provide *ex ante* protection and a weaker form of *ex post* protection. This is due to the FCA's forward-thinking approach, which attempts to prevent or rectify bad behaviour before it leads to a risk and any related harm. When harm occurs, the FCA aims to ascertain that no substantial detriment is caused to markets or consumers. The FCA also assesses a firm's culture and governance, focusing on the risk framework, whether adequate structures are in place to detect the risk of harm and whether adequate strategies are implemented to handle such risk.[1193]

Furthermore, the FCA concentrates on firm and individual accountability, approving and holding responsible the most senior executives as their decisions and behaviour significantly influence firms' conduct. The FCA's work is commensurate and risk-based, relying on its knowledge of markets and firms' practices to identify firms whose wrongdoing will generate the greatest harm. The FCA employs a two-way dialogue. It communicates both with consumers, to comprehend the challenges they face and pinpoint the firms causing harm, and with firms to learn in what manner they respond to market, firm and/or regulatory developments, and to alter their views and strategies as needed. The FCA aims to coordinate its work, with separate teams within its

[1191] Ali (n 1177).
[1192] FCA, 'FCA Mission: Approach to Supervision' (24 April 2019) 8-9 <www.fca.org.uk/publication/corporate/our-approach-supervision-final-report-feedback-statement.pdf> accessed 23 June 2022.
[1193] ibid.

different units collaborating together to make smart choices, share information and furnish coherent communications. The FCA also shares intelligence with other national and foreign regulators to supervise firms and markets, and handle common matters.[1194]

The FCA strives to rectify systematic harm that has materialised and prohibit it from reoccurring. It aims to act fast to end the harm caused and to ensure that the relevant firm handles the cause and reviews its business strategies to prohibit a reoccurrence. When it detects severe wrongdoing, the Enforcement unit launches an inquiry. Additionally, the FCA seeks to attain redress for harmed consumers. It may either require a redress scheme, direct contact with the bank, or collaborate with other bodies, for instance, the Financial Ombudsman Service.[1195]

In practice, the FCA may not always be best placed to solve the harm it identifies. Consumers are further protected by the Financial Ombudsman Service and the Financial Services Compensation Scheme (FSCS). Hence, the FCA evaluates whether detected issues would be better solved by other national or international bodies or whether they necessitate collaborative efforts between the FCA and other bodies.[1196]

6.2.3 Consumer redress availability

In order for consumers to have their minds at rest that when matters go wrong, they will be fixed, it is necessary that a solid consumer complaints and redress mechanism is in place. [1197] A number of processes hold banks responsible for breaking the FCA's rules, and provide avenues for consumers to seek remedies. These include the private right of legal action under FSMA for damages following banks' breaches of most of the rules contained in the FCA's Handbook but not the Principles; the FCA's

[1194] ibid.
[1195] ibid.
[1196] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 15.
[1197] ibid 14.

supervisory and enforcement activities; banks' own complaints and redress procedures; the Financial Ombudsman Service; the Financial Services Compensation Scheme (FSCS) and other redress schemes.[1198]

Thus, the FCA may issue rules and guidelines on the way banks should handle complaints. The FCA's Handbook Dispute resolution / Complaints sourcebook (DISP) requires banks to create, execute, and retain efficient and clear mechanisms for processing complaints in a sensible and timely manner.[1199] Furthermore, certain DISP provisions enable the FCA to seek adequate redress for customers when necessary. In December 2019, for instance, a total of GBP 332.4 million was refunded to customers complaining on the manner payment protection insurance (PPI) policies were sold to them.[1200]

The FCA has particular statutory authority, for instance, under the CRA 2015 and FSMA 2000, to act against individual banks and demand compensation. Additionally, when banks fail ubiquitously or on a recurring basis to adhere to relevant rules, the FCA has the authority to demand a widespread consumer redress scheme if consumers suffer harm for which a relief or compensation will be available if they institute legal proceedings.[1201] Since consumers cannot attain a remedy in court for a violation of the Principles, this scheme is unavailable in such circumstances. Moreover, voluntary schemes, which are applicable to banks' activities, whether regulated or not, are available. Such schemes may regard the entire banking industry or a particular bank.[1202] Compensation may also follow a criminal conviction in the form of a confiscation order pursuant to the Proceeds of Crime Act 2002. For instance, in 2017, the FCA won eight confiscation orders amounting to approximately GBP 2.2 million against eight individuals convicted of participating in an unauthorised collective

[1198] FCA, 'Consultation Paper CP21/36: A new Consumer Duty: Feedback to CP21/31 and further consultation' (7 December 2021) para 12.4 <www.fca.org.uk/publication/consultation/cp21-36.pdf> accessed 23 June 2022.
[1199] FCA Handbook, DISP 1.3.1R.
[1200] FCA, 'Monthly PPI refunds and compensation' (29 April 2021) <www.fca.org.uk/data/monthly-ppi-refunds-and-compensation> accessed 23 June 2022.
[1201] FSMA 2000, s 404.
[1202] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 15.

investment scheme consequent to which 110 lost around GBP 4.3 million. The scam's victims recovered around 40 percent of their investment.[1203]

Where customers have completed the bank's complaints procedures and are dissatisfied with the outcome, they may send their issue to an independent body, the Financial Ombudsman Service (FOS), if the issue falls within its competence. The FOS may issue a monetary award or instruct the bank to take the necessary steps regarding the complainant after having concluded that this is fair and reasonable in the case's circumstances. The FOS's present compensation limit is GBP 355,000.[1204] Thus, in May 2022, the FOS announced that it secured around GPB 22 million in compensation to consumers, most of which were bank customers.[1205] Notably, in *Clark v In Focus Asset Management & Tax Solutions*,[1206] the Court of Appeal concluded that if a consumer chooses to seek dispute resolution through the FOS, *res judicata* is applicable once the case is resolved. Notwithstanding that the damages sought exceed the FOS's award limit, a consumer cannot pursue the same legal claim in civil court. It has been contended that *res judicata* should not be applicable because the FOS is not a formal court and consumers that eventually institute legal proceedings in court will be adopting legal concepts and arguments for the first time.[1207] In this regard, it is argued that the claim should be made in respect of the amount which has not been recovered by the FOS process.

It is arguable that the statutory framework vaguely protects customers after signing contracts with banks. Such a framework has created an extrajudicial dispute resolution system whereby bank customers may file complaints with the FOS. It may be argued that they may pursue *ex post* protection against agreements which do not

[1203] FCA, 'FCA secures eight confiscation orders totalling almost £2.2 million' (24 May 2022) <www.fca.org.uk/news/press-releases/fca-secures-eight-confiscation-orders-totalling-almost-22-million> accessed 23 June 2022; 'Eight convicted for role in unauthorised collective investment scheme' (4 June 2015) <www.fca.org.uk/news/press-releases/eight-convicted-role-unauthorised-collective-investment-scheme> accessed 23 June 2022.
[1204] FOS, 'FCA confirms increase to our award limits' (12 March 2019) <www.financial-ombudsman.org.uk/news-events/fca-confirms-increase-award-limits> accessed 23 June 2022.
[1205] FOS, 'Financial Ombudsman Service secures up to £22 million in redress for consumers' (24 May 2022) <www.financial-ombudsman.org.uk/news-events/financial-ombudsman-service-secures-22-million-redress-consumers> accessed 29 May 2022.
[1206] *Clark v In Focus Asset Management & Tax Solutions* [2014] EWCA Civ 118.
[1207] Iris H-Y Chiu and Joanna Wilson, *Banking Law and Regulation* (Oxford University Press 2019) 256.

remain beneficial for their welfare, since the FOS bases its decisions on fairness or reasonableness rather than legal concepts. However, the affordability assessment has been noted to have a considerable impact on FOS judgments. It is contended that customers who become over-expanded consequent to banks' failure to evaluate their financial situation may attain redress. Yet, it is less evident whether they may obtain a remedy when no 'point-of-sale' concerns are visible. It is questionable whether, for instance, if customers' situations alter, the FOS would be capable of amending bank contract terms in such a way as to influence the customers' arrangement with banks.[1208]

6.2.4 The FCA's approach to consumer protection

On 21 October 2019, the FCA confirmed that its new focus and approach to conduct regulation was on outcomes. The UK regulatory framework was created in reaction to the 2007-2009 global financial crisis.[1209] After the crisis, regulation achieved a number of its main objectives. For instance, banks became better capitalised and managers' personal responsibility became engrained in culture. However, its regulatory strategy, which places a strong emphasis on firms' disclosures, has not always yielded the expected outcomes. The FCA appears to be eager to simplify regulation, with the correct route being towards an outcomes-based regime rather than strict adherence to particular rules. The FCA is mindful that both firms and consumers may find it difficult to comprehend the Handbook rules. It is aware that regulation could be made easier and clear to follow through an outcomes-based approach instead of more rules.[1210]

The FCA is cognisant that consumers should be responsible for their decisions and choices. It is also aware that, however, certain factors may restrict them from so doing

[1208] Chiu, Kokkinis and Miglionico (n 1068).
[1209] Iris H-Y Chiu, 'Rethinking the Law and Economics of Post-Crisis Micro-Prudential Regulation- The Need to Invert the Relation- ship of Law to Economics?' (2019) 38(2) *Review of Banking and Financial Law* 639.
[1210] Clifford Chance, 'New FCA approach could be game-changer for insurers' (12 December 2019) <www.cliffordchance.com/briefings/2019/12/new-fca-approach-could-be-game-changer-for-insurers.html> accessed 23 June 2022.

as they can affect their decisions.[1211] It is mindful that information asymmetries and behavioural biases affect consumers' decisions and behaviour, and that these can be exploited by banks, leading to harm. Furthermore, consumers' requirements and experiences are becoming increasingly complex, change with time and are influenced by diverse and complex motives. Drastic changes have occurred in society, technology and economy.[1212]

The FCA's approach to consumer protection aims to provide a platform for a proactive strategy intended to obtain a well-functioning market and good high-impact outcomes for consumers. Therefore, the FCA's approach takes into account consumers' needs, behaviour and experiences, the financial services' dynamic economic environment and the continuous changing landscape for consumers and firms, including banks. Thus, the FCA's approach is based on three strategic themes. It regulates for the actual, vulnerable and future consumers.[1213]

6.2.4.1 Differentiated rules depending on the capabilities of actual consumers

The FCA regulates for all types of consumers rather than for the economically rational mythical perfect consumer. The FCA takes cognisance of psychology and behavioural economics in regulation and policymaking. It considers the actual consumers, their interests and the challenges they experience when making decisions. It investigates and tests nudges, which are mild paternalistic interventions aimed primarily at influencing decision architecture'[1214] and effective defaults. It also builds on behavioural analysis and evaluates its actions' consequences.[1215] It has been argued that, although nudging has had a positive result on regulatory reform, nudging on its own is insufficient for improving consumer conduct and overcoming financial illiteracy. Indeed, the FCA questioned whether nudges may improve consumer inertia or

[1211] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 9.
[1212] ibid 11.
[1213] Ibid.
[1214] Caroline Hobson, 'Behavioural economics: a new basis for FCA intervention' (2014) 3(5) Compliance & Risk Journal 6.
[1215] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 29.

whether it required to take harsher actions,[1216] such as product bans in extreme situations.[1217]

The FCA uses data, technology and academic evidence to recognise consumer harm and develops solutions for actual behaviour and not ideal behaviour, that is, based on how consumers behave in practice rather than in accordance with traditional economic theory. The FCA seeks to provide remedies that go beyond disclosure and considers to improve consumer interactions, sales and marketing settings so that consumers can buy the products and services they want. It aims to act as necessary where it notices consumers' predictable, common, pervasive and serious mistakes.[1218] In other words, it is evident that the FCA assumes a more paternalistic approach to consumer protection than merely maximising market efficiency and resorting to nudges.

6.2.4.2 Regulation for vulnerable consumers

The FCA makes it clear that identification of potential harm does not imply that it will take action. The FCA is well aware that, due to its limited resources, it must prioritise where it must act, namely, where it believes the greatest harm exists. Thus, it serves to protect the most vulnerable and weakest consumers. When the FCA detects vulnerability, it evaluates consumers' immediate circumstances. It also assesses the larger effects of harm on vulnerable consumers' emotional and financial welfare. It concentrates on industries and products that are primarily utilised by consumers who are less resilient, for instance, high-cost short-term lending. Moreover, it is mindful that certain consumers are denied access to financial products or services and this can have substantial consequences on their lives. Hence, it acts on such exclusion issues.[1219]

[1216] FCA, 'Applying Behavioural Economics at the Financial Conduct Authority' (12 December 2013) 32 <https://sites-herbertsmithfreehills.vuturevx.com/49/6741/landing-pages/fca-markt-presentation-20131212-all-slides-en1.pdf> (accessed 23 June 2022).
[1217] ibid 34; Paul Ali and Ian Ramsay, 'Behavioural Law and Economics: Regulatory Reform of Consumer Credit and Consumer Financial Services' (2014) 43(4) Common Law World Review 298.
[1218] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 30.
[1219] ibid.

The FCA collects information and data to diagnose and track harm. It uses its research projects to guarantee it has timely and appropriate information on vulnerability characteristics and identify areas where harm is occurring.[1220] Moreover, it collaborates with other organisations and brings different bodies together to solve problems where it lacks the authority to do so alone, particularly in the domains of its regulatory perimeter and public policy. Additionally, the FCA works collaboratively with police and other agencies to combat criminal acts, including fraud, which hurt consumers and jeopardise the FCA's legislative purposes.[1221]

6.2.4.3 Regulation for the future

The FCA is aware that consumers' requirements from financial services may be altered by demographics and societal developments, for instance, ageing population,[1222] increasing retirement age[1223] and a young generation striving to access the home market[1224] and more habituated to debt. Consumers' requirements and the manner consumers engage in financial services are frequently affected by changes in the consumer environment. The FCA is also mindful that technological innovation is changing the financial services sector and that shift can be harmful to consumers. For instance, a rising number of consumers can use mobile and digital services, which are convenient and provide options but may exclude other consumers. Moreover, it is aware that the increased data sharing has positive and negative consequences. For instance, Open Banking expands consumers' options and permits more pertinent product and service propositions, however, many consumers are concerned about data sharing.[1225]

[1220] ibid.
[1221] ibid 11, 31.
[1222] Government Office for Science, Future of an ageing Population (2016) <www.gov.uk/government/uploads/system/uploads/attachment_data/file/535187/gs-16-10-futureof-an-ageing-population.pdf> accessed 23 June 2022.
[1223] Age UK, 'Changes to State Pension age' <www.ageuk.org.uk/money-matters/pensions/changes-to-state-pension-age/> accessed 23 June 2022.
[1224] ONS, 'UK Perspectives 2016: Housing and home ownership in the UK' (25 May 2016) <www.ons.gov.uk/peoplepopulationandcommunity/housing/articles/ukperspectives2016housingandhomeownershipintheuk/2016-05-25> accessed 23 June 2022.
[1225] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 31.

The FCA is cognisant that it must adapt to the new environment when considering its regulatory approach. The FCA is aware that certain regulatory aspects are not appropriate or efficient anymore[1226] and its approach to technology needs to be updated. The FCA Handbook rules recognise the use of technology in financial services but must be updated to accommodate entirely the manner technology is utilised and its growing importance.[1227] The FCA aims to be prepared for substantial changes which enhance the threat of harm to consumers or modify how they interact with financial services.[1228]

Thus, it is argued that the above discussion demonstrates that the FCA's strategy to consumer protection against banks provides *ex ante* protection. It may be claimed that present regulatory procedures protect consumers given that banks are obliged to treat all consumers fairly, screen for vulnerability and serve them appropriately to prevent adverse consequences. This, however, is insufficient. As discussed in Chapter Two, the FCA's concept of vulnerability is based on four main features, namely, ill-health (mental or physical), poor personal resilience, life upheavals and poor financial ability. Such an understanding of vulnerability is more limited than that of Cartwright, which includes context-specific situations, for instance, family circumstances and customer-unfriendly industry systems. Despite the FCA has strengthened banks' duty to evaluate customers' vulnerability, a wider vulnerability framework is nevertheless absent. It is further argued that the FCA should extend its concept and implementation of vulnerability evaluations, and explore the imposition of the provision of mandatory advice to bank customers. As a result, banks would be held to enhanced duties of care and regulatory discipline. Hence, banks would be obliged to adapt to customers' changing requirements.[1229]

[1226] ibid.
[1227] Clifford Chance (n 1210).
[1228] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 11.
[1229] Chiu, Kokkinis and Miglionico (n 1068).

6.2.5 The FCA's new Consumer Duty

Concerns have been consistently raised that the present regulatory regime fails to furnish appropriate consumer protection and that the obligations of consumers and firms require to be rebalanced. It has been proposed that firms, including banks, be subjected to a new 'Duty of Care' while interacting with consumers.[1230] In reply, the FCA plans to introduce a New Consumer Duty aimed at creating a more level playing for consumers. Consequent to this duty, firms will constantly require prioritising customers' interests in their activities and performing more than mere simple compliance with particular rules, focusing on providing positive outcomes for customers. Moreover, the FCA claims that competition will bring about market-wide advantages and firms should compete to entice and maintain customers as a result of heightened performance and customer contentment, as well as encourage innovation to attain positive customer results. Further, customers will acquire products and services that are suitable for purpose, fairly priced and easy to use. Customers will be supported in so doing.[1231]

The Consumer Duty will neither substitute nor impose a wide obligation on customers to bear responsibility for their decisions.[1232] However, the FCA intends to establish a higher bar for the level of care given to customers. This will oblige several firms to substantially change their culture and conduct such that they incessantly concentrate on customer outcomes and customers will be able to take effective informed decisions.[1233]

The Consumer Duty will accomplish this by expressly establishing a higher level of care throughout the entire retail market sector, advised by behavioural biases and vulnerability; expanding rules on product governance and fair market price, which are present in some areas, to all areas; concentrating on market practices which influence

[1230] FCA, 'FCA Mission: Approach to Consumers' (n 1044) 9, 24.
[1231] FCA, 'Consultation Paper CP21/36: A new Consumer Duty: Feedback to CP21/13 and further consultation' (n 1198) para 1.13.
[1232] ibid para 1.41.
[1233] ibid para 1.12.

customer decision-taking and induce harm, for instance, sludge practices; ascertaining firms take cognisance of customers' requirements, vulnerability and conduct in all aspects of their activities; and compelling firms to concentrate on and achieve positive outcomes for customers.[1234]

It is claimed that the Consumer Duty will enhance the procedural aspect of the commitment to 'treat customers fairly'.[1235] The Consumer Duty will be unique as it will comprise a new principle, essentially, Principle 12, as well as cross-cutting and outcome rules.[1236] Principle 12 is a new high-level consumer protection principle that will substitute Principles 6 and 7 for retail businesses, and will oblige firms to behave in ways which will provide positive outcomes for customers. The cross-cutting rules specify the manner firms must behave to achieve such results, namely, obliging firms to operate in good faith towards customers, prevent foreseeable harm and empower and assist them in pursuing their financial goals. The outcome rules are important aspects of the firm-customer interaction because they help attain four positive customer outcomes.[1237] These outcomes pertain to financial products and services that would meet customers' requirements;[1238] provide fair value for money;[1239] furnish clear, fair and comprehensible communications enabling customers to take informed decisions on such products and services;[1240] and afford a degree of support which would satisfy customers' needs, in pursuit of their financial objectives, throughout their relationship with the firm.[1241]

It is argued that notwithstanding that the new Duty appears to dwell on outcomes, it is questionable to what extent it considers financial welfare. The new Duty's consumer protection approach continues to concentrate on the promotion of market options and prevention of mis-selling, with the point-of-sale instant being regarded as extremely

[1234] ibid para 1.14.
[1235] S Gilad, 'Beyond Endogeneity: How Firms and Regulators Co-Construct the Meaning of Regulation' (2014) 36(2) *Law and Policy* 134; Chiu, Kokkinis and Miglionico (n 1068).
[1236] FCA, 'Consultation Paper CP21/36: A new Consumer Duty: Feedback to CP21/31 and further consultation' para 12.3.
[1237] ibid para 1.47.
[1238] ibid para 7.1.
[1239] ibid para 8.1.
[1240] ibid para 9.1.
[1241] ibid para 10.1.

crucial for customer decision-making. This is incompatible with the notion of financial products and services being credence goods, and, therefore, their quality and effects on welfare must be evaluated and adjusted continuously to satisfy customers' changing situations. It is questionable whether the new Duty comprises continuous customer reviews. Further, the ramifications on the manner firms should handle them are unclear. Any necessary e*x post* amendments are a relational rather than an economy-based concept in customer welfare management. Additionally, it is argued that financial well-being requirements, particularly in relation to customers' subjective perception of sustainability, control and welfare, continue to be unattended in this architecture.[1242]

6.3 Incoherence in conduct of business regulation

Notably, it has been argued that in the UK, the current legal framework governing conduct regulation fails to properly solve the issues which drive market failure, namely, limited competition, information asymmetries, conflicts of interest, externalities and perverse incentives. It has been claimed that market failure is conceived to be solved by conduct regulation through enhancement of market outcomes and customer welfare. It has been further contended that whilst this methodology appears to be structured in an effective analytical way, it has two major pitfalls. One is that the FCA's statutory objectives and regulatory rules do not have a direct, straightforward causal connection. The other is that the accountability structure is damaged by the absence thereof since regulatory authority may not be adequately assessed in terms of the statutory aims.[1243]

It has been further argued that, however, the statutory structure makes an indirect connection to market failure assessment by requiring the FCA to include a cost-benefit analysis (CBA) with a rule's recommendation.[1244] This gives the perception that

[1242] Chiu, Kokkinis and Miglionico (n 1068).
[1243] Iain MacNeil, 'Rethinking conduct regulation' (2015) 30(7) Journal of International Banking and Financial Law 413.
[1244] FSMA, s 138I(2)(a).

regulatory action occurs within the context of economic evaluation, which may account for a specific rule or rules' costs and benefits. It has been contended that such perception is severely questionable. From the costs' end, the effect of the rules must be considered but this is hard to predict beforehand. From the benefits' end, frequently, the determination is that regulation will reduce consumer harm and enhance investor protection to the point where the benefits outweigh the costs. The rationale given through the CBA for the establishment of the regulatory rules is essentially judgmental and qualitative notwithstanding that the CBA is semi-scientific. Thus, since the effect of regulation is difficult to anticipate and the costs-benefits comparison is very complicated, the justification frequently entails a mere declaration that the costs are warranted in view of investor protection. Hence, any purported advantage of such technical over more generic legal rules concerning consumer and investor protection has been claimed to be misleading.[1245]

It has been argued that risk is the missing connection between the statutory aims and market failure assessment. The FCA is required by FSMA to evaluate the various levels of risk associated with diverse investments and other transactions.[1246] Although market failure may cause consumer harm and establish a *prima facie* basis for regulatory action, this will solely occur where the risk of harm matches the FCA's judgment of the level of risk which the system can tolerate. However, no express or implied risk is preferred in the statutory framework. This is within the FCA's discretion. Therefore, the FCA has discretion to establish rules, determine risk tolerance and prioritise possibly competing regulatory aims, for instance, innovation, competition and consumer protection.[1247]

It is contended that conduct regulation has thus developed in an incoherent way. Consequently, it faces three major challenges. First, the procedure of developing regulatory rules fails to properly consider the function of general law, particularly, the recent rise in the extent of consumer protection. Conduct regulation's relation with law is not well balanced. Essentially, conduct regulation attempts to undertake too much

[1245] MacNeil (n 1243).
[1246] FSMA, s 1C(2).
[1247] MacNeil (n 1243).

work that general law could perform, particularly, given the increase in EU consumer protection law. Secondly, although there has been considerable discussion about financial market ethics, conduct regulation's relation with ethics, that is, ethics' role in conduct regulation, is obscure. It is unclear whether ethics-oriented high-level principles should translate unambiguously onto comprehensive conduct rules created consequent to market failure assessment that is motivated by efficiency and not ethical standards. Finally, conduct regulation complexity has reached a point where it is impeding the achievement of its goals. The application and scope of the regulatory regime in terms of customers, products and markets is complex, resulting in an outcome wherein compliance is restricted and technical instead of being influenced by an overall notion of appropriate conduct. It is suggested that whilst diverse approaches may exist to address these issues, conduct regulation will not be so effective until they are handled correctly.[1248]

6.4 Regulatory arbitrage

It is argued that the FCA's actions are limited in that the complexity of the regulatory perimeter provides opportunities to design products such that they are not regulated. For instance, London Capital and Finance plc (LCF) was discovered to have marketed and sold illiquid, unregulated retail investment products, which were 'mini-bonds' in unlisted entities, to retail investors, the majority of whom had no idea of what they were buying[1249]. These financial products were structured in such a manner as to avoid regulation. In fact, the LCF scandal raises awareness on a comprehensive product scrutiny gap in consumer investment regulation.[1250] In this regard, it has been questioned whether an alternative approach, in which financial regulation based on the economic substance of activities and products, instead of detailed rules, would produce a better outcome. It has been argued that regulation grounded on economic substance has two difficulties. One is that products must first be defined and identified

[1248] ibid.
[1249] FCA, 'Independent investigation into London Capital & Finance' (7 January 2022) <www.fca.org.uk/transparency/independent-investigation-london-capital-finance> accessed 23 June 2022.
[1250] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1105).

to have the same economic substance to be regulated. The other is that products having the same economic substance may not all be properly within the purview of financial regulation.[1251]

Hence, it is argued that although financial regulation based on economic substance may seem appealing, it has the same definitional issues as any other criterion. There is no advantage, but there is a chance that there may be more uncertainty about where regulated activity ends and unregulated conduct begins. It has been asserted that the desire of certainty is partially to blame for the plain complexity of the current regulatory framework. To do this, the legislator's drafting technique kept the old definitions in place and added new areas rather than rewrote them. It has been claimed that brevity is sacrificed in order to preserve certainty.[1252]

It is further contended that, notably, another limitation which the FCA faces is that, pursuant to the FSMA 2000, it may decide when and how to perform its statutory functions and exercise its statutory powers, but it does not determine whether or not a specific product falls within its regulatory perimeter. However, that said, provided the FCA can establish that it is acting within its statutory jurisdiction, its decision would be open to challenge only by way of judicial review and on limited grounds, including manifest unreasonableness or irrationality. Thus, in the banking context, in *British Bankers Association v Financial Services Authority*,[1253] the British Bankers Association unsuccessfully challenged the regulator's decision to pursue enforcement action for mis-selling of payment protection insurance policies, based on alleged breach of certain Principles, when the action of the firms in question was arguably compliant with existing but more limited rules, specifically applicable to the same activities.[1254]

[1251] Robert Purves, 'Financial regulation and economic substance' (2020) 35(9) Journal of International Banking and Financial Law 633.
[1252] ibid.
[1253] [2011] EWHC 999 (Admin)
[1254] ibid; Purves (n 1251).

It has been questioned why Parliament should be unwilling to leave the detail of the regulatory perimeter to the FCA. It has been contended that, possibly, the most important answer is certainty. Undertaking a regulated activity under FSMA without the necessary authorisation has significant consequences, ranging from regulatory action to prosecution, coupled with the potential unenforceability of the transaction against the other party. It is claimed that persons in the regulatory space or considering a venture that may trespass into the regulatory space, are entitled and should seek to know, in advance, whether or not their proposed activity or product is regulated, and to organise their affairs accordingly.[1255]

In *Asset Land Investments Plc v Financial Conduct Authority*,[1256] Lord Sumption held that, 'in a statute such as FSMA 2000, which deliberately sets out to regulate some forms of investment but not others, the omission of some transactions from the regulatory perimeter cannot of itself be regarded as compromising the efficacy of the statutory scheme'.[1257] However, it is arguable that the omission of certain transactions does compromise consumer protection. A case in point is the new development in unregulated buy-now pay-later (BNPL) unsecured lending. In February 2021, the FCA released its report concerning innovation and change in the unsecured consumer credit market wherein it recommended *inter alia* that BNPL products, which are currently exempt from regulation, to be included in the regulatory remit with urgency.[1258] In 2020, the utilisation of BNPL products increased dramatically. As at the date of the report, the amount was GBP 2.7 billion and five million individuals used such products ever since the COVID-19 pandemic began. Unregulated BNPL products grew in popularity, providing customers with a viable option to costlier borrowing. However, this also came with significant potential for customer detriment. For instance, more than one-tenth of a large bank's BNPL customers were already in default.[1259] Regulation would protect customers and make the market sustainable. In fact, the government issued a response to the report agreeing that HM Treasury

[1255] Purves (n 1251).
[1256] [2016] UKSC 17.
[1257] ibid [88].
[1258] FCA, 'The Woolard Review – A review of change and innovation in the unsecured credit market' (2 February 2021) <www.fca.org.uk/publication/corporate/woolard-review-report.pdf> accessed 23 June 2022.
[1259] ibid para 4.39 <www.fca.org.uk/publication/corporate/woolard-review-report.pdf> accessed 23 June 2022.

should legislate to bring unregulated BNPL activity within scope of FCA regulation.[1260] Thus, notably, it was the FCA who made the recommendation, but it was Parliament that took the ultimate decision for the actual insertion of the BNPL products within the regulatory perimeter and that, instead, could have rejected the proposal.

6.5 Limitation of the scope of financial regulation by the English courts

It is argued that case law demonstrates that English courts tend to refuse to recognise that regulatory rules create contractual or common law obligations on regulated firms, including banks.[1261] Instead, they prefer contractual formality[1262] and confirm supremacy of contract terms, because of which they limit the extent of banks' obligations and exposure.[1263] It has been argued that reasons therefor are interconnected, rendering the difficulty unsolvable. These include: (1) a prevailing judicial philosophy favouring a competitive self-reliant contract law model; (2) judicial anxiousness on tainting English contract law with foreign continental concepts of fair dealing and good faith; (3) unsatisfactory consideration for the substantive rather than simply formal consent requisites, where the signature rule in *L'Estrange v Graucob*[1264] sometimes functions as a judicial safety blanket negating further assessment; (4) an inadequately thorough evaluation of whether basis clauses should be treated as exemption clauses or not and too quick acknowledgment that these reflect a truthful arrangement establishing the extent of parties' duties, instead of exclusion of liability for their breach; and (5) a judicial tendency to be overly confident in commercial

[1260] HM Treasury, 'Regulation of Buy-Now-Pay-Later set to protect millions of people' (20 June 2022) <www.gov.uk/government/news/regulation-of-buy-now-pay-later-set-to-protect-millions-of-people> accessed 23 June 2022.
[1261] Kushal Gandhi, 'Interpretation of FCA rules and guidance: the contract triumphs' (2020) 9(4) Compliance & Risk Journal 10; eg *Target Rich International Ltd v Forex Capital Markets Ltd* [2020] EWHC 1544 (Comm).
[1262] Paul Marshall, 'Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions' (2014) 29(11) Journal of International Banking and Financial Law 679.
[1263] Gandhi (n 1261).
[1264] [1934] 2KB 394.

judgment as judges have seldomly experienced any direct personal involvement in commerce.[1265]

It is arguable that English common law and financial regulatory law commence from different *a priori* assumptions. Where not otherwise needed, English common law begins from the proposition that a buyer must care for themselves. In the context of banking, the conventional bank-customer relationship is frequently used as a starting point for judicial analysis, as if it can throw light on the actual obligations undertaken by the parties in the particular circumstances. Thus, English common law ordinarily starts from a competitive premise, a competitive model of contracting, possibly unethical to the promotion of trust between market participants, where customers must look after themselves. The notion of 'good faith', outside of certain kinds of contract, is rejected by English judges, except in strong and unusual circumstances.[1266] Contrastingly, financial regulation begins from the opposite premise and is intended to facilitate a co-operative model of contracting, including facilitating transparency of risk[1267] Having consumers' protection as one of its operational objectives, the regulatory regime requires regulated entities to treat customers fairly (TCF)[1268] and have regard to their interests. Financial regulation aims to level the playing field where an imbalance of expertise and available information, and unbalanced bargaining position exist.[1269]

In fact, in *Green & Rowley v RBS*,[1270] the Court of Appeal highlighted the sharp distinction and hard-edged border between the common law and financial regulatory law. *Adams v Options Sipp UK LLP (formerly Carey Pensions UK LLP)*[1271] has again recently confirmed such boundary. Indeed, this decision is part of a series that demonstrates English courts' attitude to the applicability and interpretation of the

[1265] Paul Marshall, 'Travels in unreality: hard cases for SMEs and the making of English financial law' (2017) 32(9) Journal of International Banking and Financial Law 540.
[1266] *Yam Sing Pte Ltd v International Trade Corp* [2013] EWHC 111 QB; Marshall, 'Travels in unreality: hard cases for SMEs and the making of English financial law' (n 1265).
[1267] *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184.
[1268] FCA Handbook, PRIN 2.1.1, Principle 6.
[1269] Marshall, 'Travels in unreality: hard cases for SMEs and the making of English financial law' (n 1265).
[1270] *Green & Rowley v The Royal Bank of Scotland plc* [2013] EWCA Civ 1197.
[1271] *Adams v Options Sipp UK LLP (formerly Carey Pensions UK LLP)* [2020] EWHC 1229 (Ch).

FCA's rules, emphasising the importance of clear contractual terms between the parties involved.[1272] In this case, the judge argued that the extent of regulatory duties is discerned by identifying the relevant factual context, that the scope of obligations imposed by the COBS rules should be interpreted starting from the contractual position.[1273] In so doing, the analysis is not whether the duties can be excluded by contract but rather what those duties are in light of the contract's provisions. According to the judge, this is supported by the fact that not every COBS obligation applies to all regulated entities or activities. The judge placed significant emphasis on the agreement which the parties had entered into, and which defined their roles and functions in the transaction. The judge pointed out that there was no provision drawn to his attention which enables the regulatory regime to take precedence over the contractual terms or which makes the contractual relationships, duties and obligations between the claimant and defendant unenforceable.[1274]

The judge further held that, in order to overcome the contractual framework for determining the regulatory obligation's scope, the court would have to find proof that the contract was artificial and the facts on the ground were different. This threshold was not exceeded in this case. The judge found that the claimant had signed the contract with the defendant knowingly and willingly, the defendant's role was execution-only and the claimant was responsible for their own investment decisions. The judge held that the COBS rule cannot be construed as imposing an obligation to advise which would not only be unlawful but which the parties had specifically agreed not to impose on the defendant in their contract. The judge ruled that, according to such contract, there were no provisions imposing an obligation on the defendant to ascertain the investment's suitability for the claimant.[1275]

It is arguable that COBS rules create contractual or common law obligations on the part of regulated firms, including banks, and, hence, should form the basis for private law contractual and tortious liability on their part. This reasoning runs much beyond

[1272] Gandhi (n 1261).
[1273] *Adams v Options Sipp UK LLP (formerly Carey Pensions UK LLP)* [2020] EWHC 1229 (Ch) [148].
[1274] Ibid [150].
[1275] Ibid [152]-[164].

the limited scope of FSMA 2000 section 138D, which allows an individual to sue for violation of a statutory duty when an authorised person has contravened a rule.[1276] In *Target Rich International Ltd v Forex Capital Markets Ltd*,[1277] the claim was to recover losses sustained by Target Rich International (TRI) on its EUR/CHF positions after the Swiss 'Flash Crash' which materialised on 15 January 2015. TRI argued that the COBS rules should be implied into each contract with a regulated firm carrying on investment business and identical obligations were owed in tort. The argument's basis was necessity or the 'officious bystander' view that it was self-evident that COBS rules should be inferred into a contract with a regulated firm. The argument was based on a ruling of the CJEU in *Genil 48 SL v Bankinter SA*.[1278]

In *Target Rich International Ltd v Forex Capital Markets Ltd*,[1279] the judge dismissed the claimant's argument because it contradicted a number of decisions in England and Scotland. For TRI to be right, each of *Grant Estates Ltd v The Royal Bank of Scotland plc*,[1280] *Green & Rowley v The Royal Bank of Scotland plc*,[1281] *Bailey v Barclays Bank plc*,[1282] *Thornbridge Ltd v Barclays Bank plc*[1283] and *Flex-E-Vouchers Ltd v The Royal Bank of Scotland plc*[1284] must have been wrongly decided, in whole or in part. The cases either decided, or proceeded on the basis that, a direct private right of action for violation of COBS rules does not exist other than through section 138D of FSMA.[1285] The judge also held that the contract was entirely functional without COBS rules. He disregarded the 'officious bystander' test, claiming that it had been rejected in similar circumstances in *Flex-E-Vouchers* wherein the argument did not even pass the summary judgment test based on the principles in *Marks & Spencers v BNP Paribas.*[1286]

[1276] Francis Tregear, 'Pushing at a closed door? Another failed attempt to widen the scope of claims against FCA authorised entities' (2020) 35(10) Journal of International Banking and Financial Law 686.
[1277] *Target Rich International v FXCM Ltd* [2020] EWHC 1544 (Comm).
[1278] Case C-604/11 *Genil 48 SL and Comercial Hostelera de Grandes Vinos SL v Bankinter SA and Banco Bilbao Vizcaya Argentaria SA* [2013] ECLI:EU:C:2013:344.
[1279] [2020] EWHC 1544 (Comm).
[1280] [2012] CSOH 133.
[1281] [2013] EWCA Civ 1197.
[1282] [2014] EWHC 2882 (QB).
[1283] [2015] EWHC 3430 (QB).
[1284] [2016] EWHC 2604 (QB).
[1285] *Target Rich International v FXCM Limited* [2020] EWHC 1544 (Comm).
[1286] [2016] AC 742.

TRI further argued that where failure to comply with a regulatory obligation is likely to cause harm to the counterparty, a common law duty of care coextensive with the regulatory obligation emerges. The judge refused this argument[1287] as it was inconsistent with the Court of Appeal's ruling in *Green & Rowley v RBS*, which rejected a similar argument, holding that the sheer existence of the COBS rules does not imply a coextensive duty of care. Section 138D of FSMA provides redress for breach of a rule in the form of an action for violation of a statutory duty. The judge also stated that no characteristic of the case exists that supports the establishment of a separate common law duty of care.[1288]

Additionally, TRI contended that the contractual documents included repeated references to the FCA's regulatory regime and stipulated that it should take precedence in case a conflict arises. It claimed that the COBS rules were explicitly integrated into the contract, or that they were 'assumed' to be binding by the contract. TRI relied on cases such as *Brandeis (Brokers) Ltd v Black*[1289] wherein rules were deemed to be included in an agreement using explicit words. However, in *Target Rich International*, the judge, citing *Flex-E-Vouchers,* rejected the contention, holding there were no incorporation words as a matter of interpretation and it was natural for a contract with a regulated firm to allude to and prioritise the regulatory regime in the event of a conflict.[1290]

TRI held that the defendant breached the best execution rule in COBS 11.2.19R. However, the judge stated that TRI miscomprehended the rule. The judge confirmed that the rule was not focused on when a legal duty to execute an order arises but with the mechanism of how such an obligation is carried out once it has arisen and any special instruction given regarding such mechanism. The judge concluded that, on a correct comprehension of the rule, TRI would have lost the case even if COBS had been included in the contract.[1291] It has been claimed that the cases reviewed in

[1287] *Target Rich International v FXCM Limited* [2020] EWHC 1544 (Comm) [88].
[1288] *Green & Rowley v The Royal Bank of Scotland plc* [2013] EWCA Civ 1197 [23].
[1289] [2001] 2 Lloyds Rep 359.
[1290] [2016] EWHC 2604 (QB).
[1291] *Target Rich International v FXCM Limited* [2020] EWHC 1544 (Comm) [113]–[119].

Target Rich International[1292] suggest that there is a cohort of cases in which similar arguments were used to circumvent the COBS rules' lack of contractual force. TRI's claim would nevertheless have failed even if the court had been convinced that the best execution rule should be recognised as a contract term.[1293]

Adams[1294] and *Target Rich International*[1295] are two decisions which emphasise the high threshold customers must cross to be successful in bank-related claims. The bank-customer contractual relationship continues to be important to English courts, and they are not readily convinced to establish obligations based on the regulatory regime, especially when this is irreconcilable with the facts.[1296]

Thus, absent convincing evidence and express agreement or payment for advice, English courts are likely to reject arguments that banks have assumed an advisory rule. *Springwell Steam Navigation v JP Morgan Chase Bank*[1297] is another case that supports such resistance. It has been argued that such resistance raises doubts given that the difference between providing information and advice is not clearly understood by individuals who sell financial products and services.[1298] In this respect, in fact, it has been claimed that, in reality, a reference to 'advice' might refer to anything from providing information to receiving independent, individualised advice from a certified professional advisor. Evidence demonstrates that the use of different definitions and terminology, such as 'independent', 'restricted', 'limited' and 'focused' advice' made the situation more difficult to comprehend for customers as well as advisors.[1299]

Further, in the past, firms, including banks, often defended mis-selling claims made by retail customers by arguing that they acted on an 'execution-only' basis. Such a

[1292] Ibid.
[1293] Tregear (n 1276).
[1294] *Adams v Options Sipp UK LLP (formerly Carey Pensions UK LLP)* [2020] EWHC 1229 (Ch).
[1295] *Target Rich International v FXCM Limited* [2020] EWHC 1544 (Comm).
[1296] Gandhi (n 1261).
[1297] [2010] EWCA Civ 1221.
[1298] eg *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184; *Zaki v Credit Suisse (UK) Ltd* [2013] EWCA Civ 14; *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch); Marshall, 'Travels in unreality: hard cases for SMEs and the making of English financial law' (n 1265).
[1299] Patrick Ring, 'The retail distribution review' (2016) 24(2) Journal of Financial Regulation & Compliance 140.

defence was intended to escape the earlier regulatory regime's severity in providing 'best advice' under the COB rules. With the appropriateness requirements established in COBS 10, it would have been natural to expect that defences of 'execution-only' transactions and denunciation of a duty to take cognisance of the customer's interests in claims regarding mis-selling of complex products to retail customers would not be available anymore. *Caveat emptor* is not applicable because a firm which sells a complex product is required to carry out an evaluative judgment as to either the product's suitability or, if such test does not apply, its appropriateness for the customer. However, the courts have kept on accepting that complex products and services may be sold on an execution-only arrangement.[1300]

Thus, in *Thornbridge Ltd v Barclays Bank plc*,[1301] a decision that was cited with approval in several subsequent High Court decisions, for instance, *Property Alliance Group v Royal Bank of Scotland plc*,[1302] Barclays asserted that the sale of a swap to a property company run by Mr and Mrs Harrison was handled as execution-only. The claimants argued and lost the case. Essentially, the issues were whether they were provided with advice and whether contractual estoppel precluded their claim. The court appears to have been unaware that COBS 10 was in force at the time Barclays sold the swap to Thornbridge. Indeed, the difference between an execution-only and an advised sale was prominent throughout the judgment, and it seems that the court's determination that no advice was furnished in connection with the swap's sale was inspired by this distinction. Contradictory to COBS 10, the court seemed to concede that Barclays could sell the swap on an execution-only basis.[1303] The manner some legal matters, particularly, contractual construction and statutory interpretation concerns, were presented for resolution, seems to have deviated the trial argument. It is argued that the regulatory rules themselves are private law duties and firms are obliged to comply with the applicable rules.[1304] In fact, it has been claimed that the

[1300] Mcllroy and Muth (n 1117).
[1301] [2015] EWHC 3430 (QB).
[1302] [2016] EWHC 3342 (Ch).
[1303] *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB); Mcllroy and Muth (n 1300).
[1304] *Shore v Sedgwick Financial Services Ltd* [2007] EWHC 2509 (QB), [2007] EWHC 3054 (QB) (Beatson J); *Seymour v Ockwell* [2005] EWHC 1137 (QB).

outcome in *Thornbridge* would have been different if such a strategy had been used.[1305]

The court decided that Barclays had not undertaken an advisory role and had not recommended the swap. Hence, the court determined Barclays bore no positive obligation to convey information that went beyond the obligation not to mislead. Furthermore, the court held that even if it decided that advice was offered, Thornbridge was precluded from claiming that Barclays had provided advice because the contract contained basis clauses, which generated contractual estoppel. The court deemed that such clauses did not fail the Unfair Contract Terms Act 1977's reasonableness test. The court also rejected the contention that the contract terms comprised a reference to the regulatory rules and that, therefore, Thornbridge had no private right of action. In other words, the court held that section 138D of FSMA did not confer a private right of action for infringement of the rules.[1306]

Thus, it is noticeable that one other difficulty which financial regulation faces is that, in response to banking requisites, English courts have developed the doubtful concept of contractual estoppel and have vigorously implemented it.[1307] Essentially, the concept provides that, pursuant to a basis clause included in the contract, parties may agree to a set of circumstances, which is, or may be, contradictory to the true state of affairs. The doctrine is unusual in that it needs the omission of representations and contractual guarantees, and has no jurisprudential basis in comparison to other types of estoppel, which all necessitate reliance and/or detriment.[1308] The keenness whereby the courts have employed it recalls the court's obsolete declaration in *Allen v Flood*[1309] that 'any right given by contract may be exercised against the giver by the person to whom it is granted, no matter how wicked, cruel or mean the motive may be which determines the enforcement of the right'.[1310] Such a mentality undermines what

[1305] Paul Marshall, 'Fault lines in English financial law: Thornbridge v Barclays Bank' (2016) 31(5) Journal of International Banking and Financial Law 266.
[1306] *Thornbridge Ltd v Barclays Bank plc* [2015] EWHC 3430 (QB).
[1307] *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch); Marshall, 'English judges prefer bankers to nuns: changing ethics and the Plover bird' (n 1186).
[1308] Marshall, 'English judges prefer bankers to nuns: changing ethics and the Plover bird' (n 1186).
[1309] [1898] AC 1.
[1310] Ibid 46.

has been dubbed the English courts' 'documentary fundamentalism'. It is partly due to the English legal system's prevailing emphasis for certainty above fairness.[1311]

In *Crestsign Ltd v National Westminster Bank plc*,[1312] the court looked at an interest rate swap which National Westminster Bank and Royal Bank of Scotland sold to Crestsign, a retail customer. This decision is significant because it relies on contractual estoppel to demonstrate the seeming conflict between contractual formality and the public interest of protection that financial regulation seeks to achieve, as well as English judges' natural predilection for the former.[1313] In this judgment, the court found that the bank had voluntarily assumed an advisory function when it recommended an interest rate swap to the customer, had negligently advised the customer and, hence, breached the duties which it had selected to undertake. Nevertheless, the judge found that the contractual relationship's explicitly concorded basis was that the bank would not be functioning as an advisor. Therefore, notwithstanding that the bank was held to be negligent, the bank was not liable for breach, neither in contract nor in the tort of negligence, due to the relationship's accepted basis, as per the bank's standard documents. Despite the court concluded that 'the bank had successfully excluded liability',[1314] the court deemed that it was a basis clause rather than an exclusion clause, which would have been subjected to the provisions of the Unfair Contract Terms Act 1977. Hence, the court ruled in the banks' favour. [1315]

It is argued that the doctrine of contractual estoppel has four major pitfalls. First, the jurisprudential basis for contractual estoppel is dubious. Although the doctrine of contractual estoppel was upheld by the Court of Appeal in *Peekay v Australia and New Zealand Banking Group Ltd*[1316] and *Springwell Navigation Corpn v JP Morgan Chase Bank*,[1317] it is nevertheless questionable in what sense it is an estoppel. It has been

[1311] Marshall, 'English judges prefer bankers to nuns: changing ethics and the Plover bird' (n 1186).
[1312] [2014] EWHC 3043 (Ch).
[1313] Marshall, 'Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions' (n 1262).
[1314] *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch) [176].
[1315] Marshall, 'Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions' (n 1262).
[1316] [2006] EWCA Civ 386, [2006] 2 Lloyd's Rep 511.
[1317] [2010] EWCA Civ 1221.

observed that all other forms of estoppel rely on some form of damage.[1318] However, contractual estoppel does not require reliance, as would estoppel through representation, or harm or unconscionability.[1319] It only needs a signature. It has been contended that the doctrine reflects courts' conscious policy decision to prioritise legal certainty, provided by clear contract provisions, over broader external circumstantial aspects.[1320] It is claimed that, nonetheless, contractual estoppel is at odds with, and may not replace, the FCA's regulatory regime.[1321]

Second, contractual estoppel favours the bank's bargaining power over the retail customer. COBS protections are proportional to the customer's experience and sophistication compared to the firm, or bank, supplying the pertinent product or service. Retail customers are afforded the strongest degree of protection because they are the least experienced and sophisticated. The COBS rules, particularly, the suitability and appropriateness requirements, acknowledge and aim to mitigate against and equalise disparities of competence in the pertinent product or service, as well as to safeguard customers. Thus, in *Crestsign*,[1322] the fact that the bank managed to successfully disclaim responsibility for the advice provided through contractual estoppel implies that the bank also succeeded to contract out of the regulatory requirements which provide protection to the customer. The judge's decision permits a regulated firm, which is in a better bargaining situation than the customer, to undermine the regulatory regime which it is required to comply with since it is precisely a regulated firm.[1323]

Third, contractual estoppel thwarts public policy because it permits liability to be excluded. Parliament's objectives have been assigned to FCA pursuant to FSMA. Hence, the FCA and its Handbook rules manifest Parliament's intentions, that is, they express public policy under FSMA and contribute to the public interest recognised by

[1318] Sean Wilken and Karim Ghaly, *The Law of Waiver Variation and Estoppel* (3rd edn, Oxford University Press 2012) para 13.22.
[1319] *Springwell Steam Navigation v JP Morgan Chase Bank* [2010] EWCA Civ 1221, [177].
[1320] Ibid [144]; *Peekay v Australia and New Zealand Banking Group Ltd* [2006] EWCA Civ 386, [2006] 2 Lloyd's Rep 511, [56].
[1321] Marshall, 'Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions' (n 1262).
[1322] *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch).
[1323] Marshall, 'Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions' (n 1262).

statute.[1324] If a regulated firm may avoid its regulatory duties by using clauses which negate the provision of advice or recommendation, as the judge ruled in *Crestsign*,[1325] Parliament's objectives are readily circumvented and supplanted. It is arguable contractual estoppel is conceptually flawed as it cuts through public policy.[1326]

Fourth, it is argued that the judge's reasoning in *Crestsign* demonstrates that contractual estoppel, may assist a firm to violate its duties under the FCA's regulatory regime. This is unacceptable.[1327] COBS 2 requirements clearly negate reliance on exclusion or restriction of liability clauses. They prohibit a firm from excluding or limiting or attempting to rely on any exclusion or limitation of any responsibility or liability it owes pursuant to the regulatory regime in communications with a customer.[1328] The court's hesitation to issue a judgment of negligence against the bank in *Crestsign* is inexplicable and incomprehensible.[1329] It is unthinkable that banks may attain such a result so easily in instances of clearly disproportionate negotiating power and expertise. Contractual estoppel enables banks to rely on courts' help to reallocate risk and escape liability for misstatements and poor or no advice because courts facilitate reliance on standard, ordinary, exclusion or restriction of liability contractual terms. It is claimed that the Supreme Court has yet to assess the jurisprudence for this doctrine of contractual estoppel.[1330]

Additionally, another problem is that courts may not have a thorough understanding of financial regulatory rules. In *O'Hare v Coutts*,[1331] the claimants, Mr and Mrs O'Hare, were entitled to institute a claim pursuant to FSMA section 138D for damages for breach of the COBS rules. Mr and Mrs O'Hare were wealthy and intelligent but lacked sophistication and experience. They were persuaded by a private banker at Coutts to invest in products, notably, Novus Funds, that were far riskier than the ones they would

[1324] see *FSA v Sinaloa Gold plc* [2013] UKSC 11.
[1325] *Crestsign Ltd v National Westminster Bank plc* [2014] EWHC 3043 (Ch) [176].
[1326] Marshall, 'Humpty Dumpty is broken: "unsuitable" and "inappropriate" swaps transactions' (n 1262).
[1327] FCA, 'Report on the Financial Conduct Authority's further investigative steps in relation to RBS GRG' (n 1190).
[1328] FCA Handbook, COBS 2.1.2R.
[1329] McIlroy and Muth (n 1117).
[1330] Marshall, 'English judges prefer bankers to nuns: changing ethics and the Plover bird' (n 1186).
[1331] [2016] EWHC 2224 (QB).

have otherwise chosen. The court determined that the O'Hares were not inexperienced investors and the information furnished to Mr O'Hare made it impossible to state that the products were mis-sold to them.[1332] The court accepted the bank's expert's evidence that skilled professionals during that time, without retrospect, would not consider investment in Novus Funds foolish for individuals as the O'Hares, and, hence, such investment was not objectively unsuitable.[1333] It has been suggested that the judge erroneously mixed COBS 9 and COBS 10.[1334]

It is argued that the fact that virtually all important first-instance decisions are, or have been, subject to appeals and that several have been compromised, leaves the legal position uncertain and incapable of resolution. Furthermore, the right to appeal has recently been severely curtailed by new court rules, which no longer allow for an oral renewal of an application to appeal that has been denied on paper.[1335] It has been argued that English courts treat banks, which have a significant synergistic relation with the law, more favourably than ordinary litigants. Courts view dishonesty accusations against banks as inherently more irrational than equivalent claims against ordinary individuals. It is questionable why this is the case. An adverse consequence is that these disparities in treatment inevitably protect banks and act as another deterrent to claims challenging their actions. This obviously exacerbates and promotes a lack of answerability, which is a serious widespread issue that the courts inadvertently are partly responsible for.[1336] Notably, there have been cases where English courts have used regulatory rules to inform private law, to decide whether case law tests are satisfied or not on a certain set of facts.[1337] This is discussed in the next chapter.

[1332] Ibid [226].
[1333] Ibid [227].
[1334] Mcllroy and Muth (n 1117).
[1335] Marshall, 'Travels in unreality: hard cases for SMEs and the making of English financial (1265).
[1336] Marshall, 'English judges prefer bankers to nuns: changing ethics and the Plover bird' (n 1262).
[1337] eg *Bankers Trust v Dharmala* [1996] CLC 252, *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184; Hudson (n 1055) para 3-25.

6.6 Consumer protection gap at point of sale – advice gap

It is arguable that customers experience an advice protection gap at point of sale[1338] despite regulatory reforms having been performed with the aim to provide for an affordable professional advice service and combat mis-selling.[1339] The Retail Distribution Review (RDR) and Financial Advice Market Review (FAMR) were two such significant reforms.[1340] Since numerous customers are unassisted in financial decision-making, possibly, because they do not afford regulated professional advice and, hence, take decisions on their own, the point-of-sale gap in consumer, or customer, protection is referred to as an 'assistance' or 'advice' gap.[1341] Such customers are more likely to experience mis-selling and bad welfare outcomes. The aforementioned LCF scandal exemplifies the advice gap's adverse consequences. Despite LCF was authorised to provide advice, it sold the mini bonds without any and customers were misguided by LCF's misrepresented risky schemes.[1342]

It has been contended that the FCA's struggle to combat conflicting investment advice and enhance the retail financial market has unintentionally resulted in the advice protection gap. Whilst customers must have confidence in professional advice's expertise, the RDR and its related expenses generated the contrary result and created the gap.[1343] Given market failure resulting from advisory objectivity being tainted by commission-fuelled conflicts of interest, the UK plunged into a dramatic transformation to entirely eliminate advisors' commission. The RDR reform altered pricing policies by obliging advisors to disclose fees to customers up front. Customers who purchase

[1338] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250); Patrick Ring, 'The retail distribution review' (2016) 24(2) Journal of Financial Regulation & Compliance 140; The people's pension, 'Public attitudes to financial advice' (February 2016) 5 <https://bandce.co.uk/wp-content/uploads/2016/02/201602-Public-attitudes-to-advice.pdf> accessed 24 June 2022.
[1339] Financial Services Authority, 'Distribution of Retail Investments: Delivering the RDR – professionalism' (2011) <www.fca.org.uk/publication/policy/fsa-ps11-01.pdf> accessed 24 June 2022.
[1340] FCA, 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' (December 2020) para 1.1 <www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf> accessed 24 June 2022.
[1341] Ring (n 1338).
[1342] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1343] ibid, Ring (n 1338).

products are no longer offered advice as an ancillary service. Advice is now deemed a premium service furnished to customers who are considering buying products. It is a unique investment service that promotes the development of an advice market.[1344]

The RDR has been accused of causing confusion. Many customers were unable to attain financial advice. Reforms to payment mechanisms for advice had advantages but also constituted challenges for customers pursuing advice. Moreover, the advice sector faces issues due to customers' behaviour. Customers' engagement is hampered by disinterest, unawareness, complexity and low numeracy and literacy. Despite internet can aid individual customers in handling finances, frequently, it is unregulated advice or advice of a restricted scope.[1345]

In fact, according to the FCA's 2020 research on the impact of the RDR and FAMR, many customers do not seek out or receive financial advice which would assist them in taking smarter investment decisions. They prefer to keep their money in cash instead of investing it. The FCA found that, in the preceding twelve months, 54 percent of UK adults, that is, around 8.4 million individuals, with GPB 10,000 or more investible assets, did not receive any official guidance with their investment decisions. The FCA considers this a potential harm because the value of money in cash is eroded by inflation and such customers may miss out on opportunities to invest their money and earn higher returns. The FCA believes that several customers would profit from assistance in making investment decisions.[1346] Furthermore, advice quality continues to be an issue since, in 2019, just 50 percent of FCA-reviewed pension investment advice was held to be suitable.[1347]

[1344] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1345] Ring (n 1338).
[1346] FCA, 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' (December 2020) paras 1.4, 1.19-1.21 <www.fca.org.uk/publication/corporate/evaluation-of-the-impact-of-the-rdr-and-famr.pdf> accessed 24 June 2022
[1347] D Gupta 'Improving the suitability of financial advice' (Speech, 12 September 2019), <www.fca.org.uk/news/speeches/improving-suitability-financial-advice> accessed 24 June 2022.

It is arguable that the advice gap for various customers that are unable to pay for advice is a situation which the market is unlikely to overcome. At the time of reform, the possibility of market exclusion was considered. However, independent advice was expected to be distinguished as the premium product, following the reform, from inferior types of advice, for instance, 'simplified', 'basic' or 'restricted' advice.[1348] It was hoped that a market for pre-sale advice or assistance, or support, would develop to fulfil customers' diverse requirements at various prices,[1349] thus, catering for the less affluent customers. However, the the FCA's attempts to promote such advancements were practically unsuccessful.[1350]

It has been argued that this is attributable in part to the absence of clarity regarding the legal risks associated with various levels of pre-sale activity. Service providers, including banks, would be enticed to furnish extremely extensive and costly advice were the provision of advice to entail the entire legal risk of suitability.[1351] It has been further argued that multiple titles provided to pre-sale support confuse customers, who, consequently, are unable to explain properly the type of request to aid create a market for pre-sale support services.[1352]

The FCA's 2020 study revealed that, while the market provides services ranging from generic, factual information to traditional comprehensive advice, substantial concentration on some forms of service is discernible.[1353] Particularly, it has centred on comprehensive advice for somewhat rich customers,[1354] bolstering previous review conclusions.[1355] Many ordinary customers, who cannot pay for costly, comprehensive

[1348] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1349] N Moloney, *How to Protect Investors* (Cambridge University Press, 2010) ch 4.
[1350] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1351] ibid.
[1352] Ibid; Patrick Ring 'Analysing the reform of the retail financial advice sector in the United Kingdom from an agencement and performativity perspective' (2015) 19 Competition and Change 390.
[1353] FCA, 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' (n 1346) paras 1.22-1.23.
[1354] ibid; Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1355] Europe Economics, 'Retail Distribution Review: Post-Implementation Review, Report for the FCA (16 December 2014) <www.fca.org.uk/publication/research/rdr-post-implementation-review-europe-economics.pdf> accessed 24 June 2022.

continuous advice, navigate unassisted through a plethora of product options,[1356] and and have to confront firms' express provisions excluding provision of advice to obtain more complex products.[1357] It is argued that despite the Money Advice Service[1358] provides generic advice as a public service,[1359] it falls short of meeting the advice gap.[1360] General advice is inadequate to address customers' unique requirements and the various economic and financial issues several customers face.[1361]

It has been argued that numerous customers who cannot afford authorised professional advice and take decisions unassisted may benefit from the creation of automated advice, or robo-advice.[1362] It is contended that, however, the development thereof has been modest and has still to attract many more customers.[1363] Furthermore, advisers seem to be under minimal competing pressure to create and provide novel, cheaper services, or target customers who are less well-off. Competition does not necessarily operate in customers' interests.[1364] The effectiveness of automated advice is restricted unless advisers' fears regarding responsibilities and costs for this type of advice are adequately addressed and mitigated, and the FCA develops a regulatory strategy that properly assists and safeguards the unknowledgeable and inexperienced customers, who are solicited by this service.[1365] It is further argued that automated advice may not always be tailored in accordance with customers' personal needs and circumstances.

It is debatable whether customers' financial knowledge would be appropriate for making sound investment decisions in the absence of advisory assistance. It has

[1356] Ring, 'The retail distribution review' (2016) 24(2) (n 1338).
[1357] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1358] Money Advice Service will shortly change to MoneyHelper <www.moneyadviceservice.org.uk/en.html> accessed 4 June 2022.
[1359] See <www.moneyhelper.org.uk/en> accessed 24 June 2022.
[1360] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (2021) (n 1250).
[1361] A Zokaityte 'The UK's money advice service: edu-regulating consumer decision-making' (2018) 47 Economic Notes 387.
[1362] Ring, 'The retail distribution review' (n 1338).
[1363] FCA, 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' (n 1346) para 1.23.
[1364] ibid para 1.22.
[1365] Ring, 'The retail distribution review' (n 1338).

been argued that generic financial education is insufficient in helping customers make specific judgments.[1366] It is contended that customers need to be capable of forecasting credence goods' performance; such financial ability requires more than basic knowledge.[1367] Moreover, financial products and services are becoming progressively complicated,[1368] posing significant challenges to customers' decision-making. The FCA appears to recognise that customers pushed outside the advice market need pre-sale help.[1369] The FCA's discussion regarding ways and means to motivate investment firms to furnish advice without exposing themselves to the legal dangers thereof reflects this.[1370] As the sale of complex products and services to customers is increasing due to the availability of online platforms, pre-sale assistance is becoming progressively critical.[1371]

The FCA is aware that more change and progress of services which satisfy better mass market customers' needs at different stages of their lives, and support customers in engaging with their financial affairs, taking the right decisions and making the most of their money.[1372] The FCA is mindful that the regulatory regime makes it difficult to boost market growth and address these customer requirements, and that more specialised and easier support and advisory services are necessary.[1373]

It is argued that as the degree of complexity rises in a financial decision, so does the presumed requirement for assistance. Customers view such choices to be more complicated when they are out of their safety zone. Moreover, customers need one-off assistance in taking particular decisions, especially if they are complex, crucial and

[1366] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1367] OJ Williams and SE Satchell, 'Social welfare issues of financial literacy and their implications for regulation' (2011) 40 Journal of Regulatory Economics 1.
[1368] D Bugeja, *Reforming Corporate Retail Investor Protection: Regulating to Avert Mis-Selling* (Hart Publishing 2019) 3–12.
[1369] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1370] FCA, 'Call for Input: Consumer Investments' (15 September 2020), <www.fca.org.uk/publications/calls-input/ consumer-investments> accessed 24 June 2022.
[1371] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1372] FCA, 'Evaluation of the impact of the Retail Distribution Review and the Financial Advice Market Review' (n 1346) para 1.4.
[1373] ibid para 1.24.

possibly life-changing, such as in the case of an equity individual savings account (ISA).[1374] It has been observed that except in the case of investment portfolio management, customers believe they do not require regular continuing support.[1375] It is argued, however, that it is likely that sometimes they may not realise that they do actually need continuing support.

Further, it has been predicted that the economic consequences of the COVID-19 pandemic will augment the need for debt advice. Such advice is fundamental for a protracted market's viability and even more so during the recovery from the pandemic. In order to maintain a healthy credit market, a well-functioning debt advice sector is required. It is critical that a secure debt advisory service is available to anyone that needs it. In turn, providers of free debt advice require sustainable long-term funding to deliver such a service.[1376] Following the pandemic, according to the Woolard Review Report, demand for debt advice was estimated to climb to as many as 1.5 million additional cases.[1377] Debt remedies must be appropriate, which means that acknowledged issues in the personal insolvency sector must be addressed, and fees for debt relief orders should not prohibit the poorest customers from receiving assistance. Funding must be available to assist such customers in paying expenses associated with filing applications for debt relief orders.[1378]

It is contended that, despite its good intentions, the RDR established a specific market for advisory services and fostered a market distortion for pre-sale help accessibility. This must be corrected.[1379] Customers require assistance to analyse the market and take an optimal purchase decision. This is critical for preventing mis-selling, fraud and scams, and, ultimately, for financial welfare.[1380] Current regulation does not cover

[1374] ibid paras 2.5-2.6.
[1375] ibid para 2.7.
[1376] FCA, 'The Woolard Review – A review of change and innovation in the unsecured credit market' (2 February 2021) 5 <www.fca.org.uk/publication/corporate/woolard-review-report.pdf> accessed 24 June 2022.
[1377] Ibid para 2.28.
[1378] Ibid 5.
[1379] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1380] J Kozup and JM Hogarth 'Financial literacy, public policy and consumers' self-protection' (2008) 42 Journal of Consumer Affairs 127.

such a comprehensive aspect of customer decision-taking. The demand for decision-taking assistance has become constant.[1381] It is debatable whether such an advice gap can be satisfied simply by enhancing the information provided in standard compulsory disclosures[1382] and preparing suitability reports following the provision of advice.[1383]

6.7 Consumer protection gap relating to post-sale care

It is arguable that bank customers are exposed to a gap in post-sale protection. Customers may need to review banking services and contracts in new situations or may require assistance for ongoing decisions in respect of certain services, for instance, investments. Ordinarily, banks are not obliged to provide post-sale care and conduct periodic reviews for customers except as explicitly requested when acting as investment advisers or in the case of portfolio management. It is argued that this is inappropriate because several customers do not afford to receive continuing comprehensive advice. Hence, post-sale care is deficient.[1384]

Given that financial products and services are credence goods and, therefore, their welfare outcomes can solely be discovered over time, bank customers remain customers beyond the point of sale. Hence, they may require aid in making ongoing decisions, regarding the credence good, which significantly influence their future financial well-being. However, since banks are not obliged to provide ongoing post-sale care, they may simply examine customers' interests at the point of sale, with little regard for their extended requirements.[1385] Moreover, notwithstanding that online access to digital platforms and automated advice make products and services more

[1381] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1382] ibid; see Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU [2014] OJ L73/349 (MiFID Commission Regulation) 2017/565, Arts 44–50.
[1383] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250); MiFID Commission Regulation, art 54.
[1384] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1385] Ibid.

accessible and cost-effective,[1386] they may be designed in such a way that highlights self-care and consumption choice. Hence, digitalisation may aggravate the situation because it provides instant contentment and dissociates from satisfying customers' ongoing requirements.[1387]

Furthermore, it may be arguable that, in regard to certain banking services, such as consumer credit, financial regulation adopts a more paternalistic regulatory intervention in post-sale care.[1388] Thus, with respect to a mortgage, a bank is obliged to explore other alternatives prior to contemplating property possession,[1389] hence, providing a degree of post-sale customer protection in credit arrangements. However, this is lacking in retail investment and other types of consumer credit. It is therefore argued that there is failure in relation to credence goods due to absence of advice that considers customers' long-term requirements. It is further claimed that such credence goods as consumer credit and investments require a relational approach to advisory services[1390] and warrant regulatory intervention for the provision of post-sale care.[1391]

6.8 Consumer protection gap relating to welfare outcomes

It is argued that bank customers experience a protection gap regarding their financial welfare outcomes. It may be contended that such welfare consequences are private commodities which regulation is unable to guarantee.[1392] However, customers partake in financial markets as a result of discretionary preferences as well as socio-economic

[1386] The people's pension (n 1338).
[1387] Tatiana Nikiforova 'The place of robo-advisors in the UK independent financial advice market: substitute or complement?' (31 August 2017) at <http://ssrn.com/abstract=3084609> accessed 24 June 2022; Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1388] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1389] FCA Handbook, MCOB 13.3.2A.
[1390] T Williams 'Who wants to watch – a comment on the new international paradigm of financial consumer market regulation' (2013) 36 Seattle University Law Review 1217.
[1391] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1392] David T Llewellyn 'Consumer protection in retail investment services: protection against what?' (1994) 3 Journal of Financial Regulation and Compliance 43.

policy, since they have primary responsibility to safeguard their financial welfare when the government fails to do so. For instance, investment may be essential to cater for medium to long term requirements, such as housing, higher education and retirement.[1393] Moreover, welfare deficits and losses are not simply private concerns but also social, relating to mass market and national foundations of investment involvement.[1394] In fact, such regulatory measures as obligatory occupational pensions saving schemes enrolment[1395] are based on the social aspect of investment involvement.[1396]

It is further claimed that certain areas of financial regulation are seldomly associated with financial welfare outcomes.[1397] For instance, in the consumer credit sector, evidence of welfare losses[1398] supports regulatory intervention whereas research on welfare consequences in the investment services area is lacking. Additionally, it is argued that although certain *ex ante* protection measures, for instance, enhanced mandatory disclosure and communication, and advisory obligations, are in place, there is scope for more *ex ante* regimes, for instance, a product approval procedure. Such a process would aid financial regulation to combat mis-selling and financial crime, including fraud and scams. For example, the LCF scandal could have been prevented had such a process been implemented.[1399]

Moreover, it is contended that gaps exist in *ex post* redress.[1400] As already discussed previously, while a few e*x post* protection measures, such as FCA-mandated collective redress, out-of-court dispute settlement process, specifically, the Financial Ombudsman Service, and banks' duty to maintain effective customer complaint-

[1393] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1394] Dimity Kingsford Smith and Olivia Dixon 'What next for the financial consumer: more disclosure? Caveat vendor? Fintech online?' in Geraint Howells, Iain Ramsay and Thomas Wilhelmsson (eds), *Handbook of Research on International Consumer Law* (2nd edn, Edward Elgar Publishing 2018) ch 15.
[1395] Pensions Act 2008, s 3.
[1396] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1397] ibid.
[1398] AK Aldohni 'The UK new regulatory framework of high-cost short-term credit: is there a shift towards a more "law and society" based approach?' (2017) 40 Journal of Consumer Policy 321.
[1399] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1400] Ibid.

handling procedures, are implemented, these are insufficient and unsatisfactory. The Financial Ombudsman Service cannot grant a compensation greater than GBP 355,000 and bank customers have a private right of action against alleged breaches of banks' obligations imposed by COBS but not the Principles.

Furthermore, in addition to mis-selling, fraud and scams that have negative repercussions for customers, inferior banking services and products, for instance, poor investment performance, may result in poor welfare outcomes. It may be claimed that poor outcomes are beyond banks' control and that bank contracts should not be reopened to pursue redistribution in customer-detrimental outcomes.[1401] However, it appears that there is a disparity between banks and customers in terms of both welfare and injustice.[1402] Customers may incur severe personal welfare consequences, for instance, old-age impoverishment, while banks would have reaped the benefits of advisory payments, investment management costs and other perks during the product's life cycle.[1403] Banks' short-term and restricted accountability may be lawful but questionable. Customer protection should incorporate legislative considerations and policy reasoning on the manner customers should handle ongoing market risks.[1404] Letting customers to do so alone is socially unacceptable given expertise and information asymmetries, and complexity in certain products and services. Risk realisation for mass market customers is a societal concern.[1405]

It is argued that a comprehensive strategy to customer protection is lacking.[1406] Financial regulation focuses primarily on procedural matters, for instance, market choice accessibility and decision-making tools. It must put a greater emphasis on

[1401] E Voyiakis 'Unconscionability and the value of choice' in M Kenney and others (eds), *Unconscionability in European Private Financial Transactions* Cambridge University Press 2010) ch 5.
[1402] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1403] ibid.
[1404] Niamh Moloney 'Regulating the retail markets: law, policy, and the financial crisis' (2010) 63 Current Legal Problems 375.
[1405] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1406] The Rt Hon Dame Elizabeth Gloster DBE, Report of the Independent Investigation into the Financial Conduct Authority's Regulation of London Capital & Finance plc (10 December 2020) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/945247/Gloster_Report_FINAL.pdf> accessed 5 June 2022.

customer welfare outcomes. It may be argued that the FCA has given attention to welfare consequences as it has provided for vulnerable customers.[1407] However, as discussed earlier in this chapter, the FCA's vulnerability framework is essentially concerned with point-of-sale stage and fails to significantly address after-sale welfare implications. The FCA defines vulnerability rather restrictedly, in terms of an enhanced risk of harm consequent to mis-selling and financial crime.[1408] Therefore, broader concepts of unsatisfactory and substandard welfare outcomes, which may nonetheless have serious repercussions on customers' basic living, plans and progress, are omitted.[1409] Furthermore, as again outlined earlier in this chapter, the FCA's concept of vulnerability focuses on physical or mental ill health, life upheavals, poor personal resilience and poor financial ability. Such notion of vulnerability is contrastingly more limited than the one extensively discussed in Chapter Two, which comprises such criteria as customers' family circumstances and unfavourable market frameworks.

Moreover, vulnerability has mainly evolved in response to consumer credit harm avoidance.[1410] It fails to adequately incorporate investment products and services. Thus, if customers purchase investment products to safeguard dependents, failure thereof can adversely harm such dependents. Hence, in this context, vulnerability should take cognisance of dependency and adverse consequences to dependents.[1411]

Many ordinary customers are or can become vulnerable in various ways[1412] and can be severely affected by the negative consequences of financial products and services. For instance, customers' absolute or heavy reliance on financial products or services

[1407] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (February 2021) (n 1065).
[1408] Ibid para 1.23.
[1409] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1410] Louise Overton and Lorna Fox O'Mahony 'Stakeholder conceptions of later-life consumer vulnerability in the financial services industry: beyond financial capability?' (2018) 41(2) Journal of Consumer Policy 273.
[1411] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).
[1412] Peter Cartwright, 'Understanding and protecting vulnerable financial consumers' (2015) 38 Journal of Consumer Policy 119; see also JM Paterson and G Brody '"Safety net" consumer protection: using prohibitions on unfair and unconscionable conduct to respond to predatory business models' (2015) 38 Journal of Consumer Policy 331.

for long-term economic support renders these customers vulnerable because failure of such products and services to perform adequately will result in a substantial welfare deficit. According to the FCA's 2020 Financial Lives Survey, 27.7 million UK adults are deemed vulnerable given the economic difficulties due to the Covid-19 pandemic.[1413] Hence, the FCA issued generic guidelines for firms, including banks, on how to handle vulnerable customers. These guidelines indicate that vulnerability evaluations should not be restricted to consumer credit.[1414] However, it also demonstrates clearly that customers' welfare consequences are still restricted to prohibiting harm solely at point-of-sale stage and focus to avoid mis-selling.[1415] Customers' post-sale challenges on welfare outcomes are unaddressed.[1416]

6.9 Conclusion

This chapter argues that the regulatory regime allows a certain degree of freedom of contract as it promotes customer choice and accessibility to banking products and services, and endorses the principle that bank customers are primarily responsible for their decisions. Furthermore, the chapter argues that the regulatory regime also carries out paternalistic intervention but fails to provide the kind of impure paternalism which has been embraced in Chapter Two. This is so because financial regulation furnishes essentially a restricted degree of ex ante protection and an even more restricted extent of ex post protection, in other words, practically no ex post protection. Ex ante protection is provided the FCA's deterrence and the imposition of numerous obligations on banks pursuant to the FCA's Handbook Principles and rules, notably, the COBS, BCOBS, CONC and MCOB rules. The chapter contends that these Principles and rules focus on banks' conduct at the point-of-sale stage of a banking product and/or service. They practically impose no duties on banks beyond the point-of-sale stage and during the product or service's life cycle, that is, during the bank-

[1413] FCA, 'Financial Lives Survey: the impact of coronavirus: Key findings from the FCA's Financial Lives 2020 survey and October 2020 Covid-19 panel survey' (11 February 2021) 18 <www.fca.org.uk/publication/research/financial-lives-survey-2020.pdf> accessed 24 June 2022.
[1414] FCA, 'Finalised Guidance: FG 21/1 Guidance for firms on the fair treatment of vulnerable customers' (February 2021) (n 1065).
[1415] Ibid para 2.19.
[1416] Chiu, 'More paternalism in the regulation of consumer financial investments? Private sector duties and public goods analysis' (n 1250).

customer relationship. There are only very few exceptions, for instance, with respect to mortgages, where the bank has to explore plausible alternatives before taking possession of the customer's property.

The chapter further claims that although the new Consumer Duty, which will be introduced as a high-level Principle, appears to address outcomes, it nevertheless targets point-of-sale stage and aims to facilitate market choice and avoid mis-selling. It is debatable whether it comprises continuous review for bank customers throughout their relationship with banks. The chapter also makes aware that the *ex ante* protection afforded by the FCA's regulatory regime is further limited given its inherent incoherence, regulatory arbitrage and the advice gap present at the point-of-sale stage, consequent to which customers may not adequately engage in banking services and may not take optimal financial decisions.

Moreover, the chapter argues that *ex post* protection is provided by the FCA's enforcement and collective redress powers; bank customers' private right of action pursuant to FSMA section 138D for breaches of relevant regulatory rules but not the Principles, including the new Consumer Duty; and the out-of-court dispute resolution mechanism furnished by the FOS. The chapter further contends that, however, such *ex post* protection is drastically curtailed given the FCA's limited resources and the FOS's lack of precedent and its award limit being capped at GBP 355,000. Furthermore, the chapter points out that a major limitation on the effectiveness of *ex post* protection is the fact that English courts refuse to recognise that the regulatory regime imposes private law obligations on banks and that they cannot be limited or excluded by exclusion or limitation of liability clauses.

Additionally, the chapter argues that two customer protection gaps, one relating to post-sale care and the other concerning financial welfare outcomes, also reduce *ex post* protection for bank customers. Given that the regulatory regime does not impose any obligations on banks beyond the point-of-sale stage, banks are not required to provide post-sale care and conduct periodic reviews for their customers. However, such post-sale care is necessary since banking products and services credence

goods, whose performance is solely discernible over time. Nonetheless, customers are left unassisted to handle ongoing market hazards and ongoing decisions, for instance, in relation to investments and credit. Moreover, the FCA does not monitor banking products and services' welfare consequences and bank customers are unassisted in any welfare difficulties they face beyond point of purchase. Accordingly, in the event that customers may require to review their banking contracts due to unfortunate life-changing circumstances, they are left alone to negotiate with banks.

Thus, this chapter extensively illustrates that the regulatory regime fails to adequately protect bank customers. Hence, it reinforces the overall argument of the thesis that a synthesis of private law and regulation is necessary to provide a coherent system of finance law which will adequately provide bank customer protection.

Chapter Seven

Reforming Banks' Duties to Customers: A New Statutory Fiduciary Duty and its Implementation

7.1 Introduction

Previous chapters have demonstrated comprehensively that the current legal and regulatory framework, formed by private law and regulatory principles, fails to provide adequate protection to bank customers. Common law starts from the premise that the bank-customer relationship is an arm's length one regulated by contract law. The parties can prioritise their own interests and banks do not owe customers a general fiduciary or advisory duty. Contract law furnishes a narrow degree of *ex ante* protection pursuant to the requirement of a valid consent to conclude a contract, the doctrine of undue influence and the penalty rule. Consumer protection legislation provides *ex ante* protection through certain provisions of the CCA relating to banks' subjection to an authorisation regime, constrained advertisements, thorough information disclosure and cooling-off periods. Consumer protection legislation furnishes limited *ex post* protection through provisions in the CRA and CCA requiring courts to review the fairness of the bank-customer relationship and/or contract terms, the relevant CRA's provisions not being applicable to the contract's core terms or price's terms when such terms are transparent and prominent, and those of the CCA being applicable to the contract's core terms but only in relation to credit agreements.

Tort law provides no *ex ante* protection and a limited degree of *ex post* protection pursuant to the torts of deceit and negligence, including the tort of negligent misstatements. The MA also furnishes no *ex ante* protection and a narrow degree of

ex post protection in providing that anyone, therefore including banks, making an innocent misrepresentation that motivates another to enter into a contract consequent to which the latter suffers loss is liable as if the misrepresentation was carried out fraudulently. Although courts may provide a degree of *ex post* protection, they are hesitant to hold banks liable for having furnished no or negligent advice to a customer under a contractual duty of care or at common law.

Further, financial regulation provides primarily *ex ante* protection through its Principles, and regulatory rules contained in its Handbook. Additionally, although the FCA's proposed new Consumer Duty, which will be introduced as Principle 12, focuses on good outcomes, thereby providing a certain degree of *ex post* protection, it is unclear whether such duty will oblige banks to conduct continuous review of consumer contracts and consumers' welfare. Moreover, none of those Principles, including the new Principle, is actionable in court. Therefore, while the new Consumer Duty may bring about a small improvement, it is not a big reform because it would still be within the same framework as the other eleven principles, which means it is excluded from a private right of action. Consequently, it is not fundamentally changing the approach of doing things and matters will essentially remain the same. Additionally, pursuant to section 138D(2), a breach of FCA's regulatory rules is actionable[1417] but under stringent restrictions making them hard to enforce.[1418] Section 138D(2)'s seeming plainness is compromised, given that the relevant rules are fragmented and strayed all over the FCA's Handbook.[1419] Whilst the FCA has enforcement powers and can impose sanctions, fines and penalties on both actionable rules and non-actionable Principles, this will not provide compensation for customers.

Moreover, the statutory framework has established the FOS, which is not bound by law, applies just and integrity criteria and can consider the eleven regulatory Principle and the future twelfth Principle. However, while it may provide *ex post* protection, it is

[1417] FCA Handbook, MCOBS, sch 5; FCA Handbook, BCOBS sch 5; FCA Handbook, COBS sch 5; FCA Handbook, CONCS sch 5.
[1418] Law Commission, 'Fiduciary Duty of Investment Intermediaries – Consultation Paper No 215' (2013) 128-9, <www.lawcom.gov.uk/wp-content/uploads/2015/03/cp215 _fiduciary_duties.pdf> accessed 20 May 2022.
[1419] Keith Stanton, 'Investment advice: The statutory remedy' **(**2017) 33(2) Journal of Professional Negligence 153.

unclear whether it does furnish such protection in the absence of point-of-sale issues and whether it would amend contract terms following changes in bank customers' circumstances. Moreover, the FOS is not bound by precedent.

Thus, it is argued that the current legal and regulatory framework is deficient in *ex ante* and, especially, in *ex post* protection. This framework fails to address any *ex post* amendments required in bank contracts necessitated by customers' life-changing situations and, hence, ultimately fails to consider customers' long-term interests and financial welfare. The welfare of customers who are end-users of banking services and the general economy is critically important.[1420] It is further argued that, hence, the current legal and regulatory framework does not provide the kind of impure paternalism which has been so thrummed on in Chapter Two.

In light of the above, this chapter explores what kind of reform is necessary to provide the necessary impure paternalism and adequate protection to bank customers. The chapter argues that this is achieved by a synthesis of private law and financial regulation to form a coherent system of finance law. The chapter proposes and contends that this is possible through primary legislation which would provide a statutory fiduciary duty owed by banks to customers. The chapter further explores the configuration of the fiduciary duty that should be furnished which the existing law does not impose on banks. The chapter also anticipates and responds to counter arguments to the proposal made. Finally, the chapter recommends a realistic and plausible method of implementing the statutory fiduciary duty, namely, through public funding by the FCA.

7.2 Proposal for a Statutory Fiduciary Duty

In the current system, there is no way for bank customers to go to court for breach of regulatory rules because they would probably lose the case. There is no fiduciary

[1420] Alastair Hudson, *The Law of Finance* (2nd edn, Sweet and Maxwell 2013) para 32-28.

duty, no general private law duty to take care of customers' interests. If, for instance, an unsuitable banking service is sold to a customer, it is against regulatory rules but not against private law which is very laissez faire. As discussed in Chapter Six, courts often refuse to recognise regulatory rules. Admittedly, in the case of the PPI scandal, the current system actually worked, and some compensation was delivered to customers. However, this does not imply that regulatory intervention is readily available in all cases. In this case, the FCA acted because there were numerous customers' complaints. It conducted investigations and, thereafter, forced banks to compensate customers. However, the FCA took years to accomplish this, and it is possible that the FCA would not have done so had it not received the tremendous number of relevant complaints.

It is argued that since the current framework fails to provide the kind of legal intervention, the kind of impure paternalism which has been thoroughly discussed in Chapter Two, which provides adequate *ex ante* and *ex post* protection to bank customers, a new reform is required. It is argued that such a reform necessitates a synthesis of private law and financial regulation to have a complete, coherent system of finance law which will provide the requisite impure paternalistic intervention whose objective is to ensure bank customer welfare[1421] both when the bank contract is concluded and throughout its duration until termination. It will therefore protect customers at pre-sale as well as at post-sale stages. It is further argued that this may be achieved through primary legislation which imposes a statutory fiduciary duty on banks to customers.[1422] Indeed, it is claimed that the most onerous duty in private law is the fiduciary duty,[1423] which requires higher standards than regulatory rules.[1424] The new act of Parliament would *inter alia* enhance justice accessibility for bank

[1421] Alastair Hudson, 'The Synthesis of Public and Private in Finance Law' in K Barker and D Jansen (eds), *Private Law: Key Encounters with Public Law* (Cambridge University Press 2013).
[1422] Ruth Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' in Costanza A Russo, Rosa M Lastra and William Blair (eds), *Research Handbook on Law and Ethics in Banking and Finance* (Edward Elgar Publishing 2019) 214.
[1423] ibid.
[1424] Conflict of interest is a notable example. While the fiduciary duty takes a severe restrictive stance, that of regulation is to managing such conflict to prevent negative consequences to customers; see *Aberdeen Railway v Blaikie Bros* (1854) 1 MacQueen 461 (HL); Iain MacNeil, 'Rethinking conduct regulation' (2015) 30(7) Journal of International Banking and Financial Law 413.

customers.[1425]

It is argued that, for the attainment of finance law coherence, the conventional attitude to legislative frameworks must be abandoned and the interactions between private law and financial regulation must be directly addressed.[1426] The coherence concept, which underlies developed systems of law,[1427] requires doctrines and rules to be applied in such a manner as to promote outcomes compatible with any cardinal concept.[1428] Bank customers need a synthesised finance law where private law and regulatory principles can effectively prohibit and rectify banks' misconduct, thereby affording them adequate protection for their welfare. This may occur solely when the two currently distinct systems can merge.[1429]

It may be questioned why the statutory duty must be a fiduciary one. It may also be contended that the imposition of a statutory fiduciary duty on banks is impractical and excessive. In response, it is argued that, as discussed extensively in the previous chapters, bank customers' behavioural biases; weak position in terms of information asymmetries, bargaining position and dependence on banks; vulnerability; necessity of banking services, possibility of financial exclusion; banks' misconduct; the resulting need for legal protection to be impurely paternalistic; and the inadequate protection provided by the current legal and regulatory framework justify that such a duty is owed by banks to customers. The enactment of an act of Parliament imposing a fiduciary obligation on banks would provide adequate *ex ante* and *ex post* protection and the necessary paternalism which bank customers require.

[1425] Elise Bant and Jeannie Marie Paterson, 'Consumer Redress Legislation: Simplifying or Subverting the Law of Contract' (2017) 80(5) Modern Law Review 895.
[1426] ibid.
[1427] *Miller v Miller* (2011) 242 CLR 446.
[1428] Bant and Paterson (n 1425).
[1429] Hudson, 'The Synthesis of Public and Private in Finance Law' (n 1421).

7.2.1 Increased Awareness of the Fiduciary Duty as a means for enhancing moral standards

It is noted that awareness of the fiduciary duty as a measure to enhance moral and ethical standards grew with time. The 1986 'Big Bang' of the London Stock Exchange demanded a fundamental overhaul of the investor protection framework.[1430] It has been claimed that the 1980s amendments were allegedly not aimed to become an extensive investment business law code but an added layer of protection that would exist alongside the fiduciary obligations established by agency law.[1431] Furthermore, it had already been acknowledged back in 1992 by Professor Finn:

> It is clearly possible for a bank, because of the manner in which it conducts itself either in its financial dealings with a customer or borrower, or in its dealings with a customer's guarantor, to find itself in a fiduciary relationship.[1432]

The fiduciary duty applies to several financial services transactions and has a crucial investor protection role.[1433] It is recognised in the multi-functional bank's investment activities,[1434] mainly, custodian function,[1435] stockbroking activities,[1436] discretionary portfolio management[1437] and financial advice.[1438]

[1430] Laurence Cecil Bartlett Gower, *Review of Investor Protection — Part 2I* (HMSO 1985) para 4.14.
[1431] P Graham, 'The Statutory Regulation of Financial Services in the United Kingdom and the Development of Chinese Walls in Managing Conflicts of Interest' in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon 1992) 47; Gerard McMeel, '"The enforcement of basic norms of commerce and of fair and honest dealing": holding banks to higher standards (Part Two)' (2018) 33(5) Journal of International Banking and Financial Law 294.
[1432] Paul Finn, 'Fiduciary Law and the Modern Commercial World' in E McKendrick (ed), *Commercial Aspects of Trusts and Fiduciary Obligations* (Clarendon 1992) 11.
[1433] MacNeil, 'Rethinking conduct regulation' (n 1424).
[1434] Gerard McMeel, '"Every word you just said was wrong": holding banks to higher standards (Part One)' (2018) 33(4) Journal of International Banking and Financial Law 218; Plato-Shinar (n 1422) 222; House of Lords, House of Commons, 'Changing Banking for Good – Report of the Parliamentary Commission on Banking Standards, Vol II' 85 (2013) <www.parliament.uk/globalassets/documents/banking-commission/Banking-final-report-vol-ii.pdf> accessed 22 May 2022.
[1435] Financial Services and Markets Act 2000, s 139; FCA Handbook, CASS; *Marley v Mutual Security Merchant Bank & Trust Co Ltd* [1995] CLC 261.
[1436] *Armstrong v Jackson* [1917] 2 KB 822.
[1437] *Diamantides v J P Morgan Chase Bank* [2005] EWCA Civ 1612 [42] (Moore-Bick LJ).
[1438] *Woods v Martins Bank* [1958] 1 WLR 1018, [1959] QB 55; *Rubenstein v HSBC* [2011] EWHC 2304 (QB); [2012] EWCA Civ 1184.

Such an awareness of the fiduciary duty also increased in recent years.[1439] The July 2012 Kay Review of UK Equity Markets and Long-Term Decision Making proposed that all players in equity investment chain should comply with fiduciary norms when dealing with customers, irrespective of classification. These standards should not be overridden by contract terms.[1440] Moreover, fiduciary duties were comprehensively referred to in the UK Law Commission's report on Fiduciary Duties of Investment Intermediaries, which document primarily dealt with fiduciary duties in the pensions' area.[1441] Additionally, as at the time of writing, the UK Law Commission was considering whether a vigorous duty of care should be imposed on banks towards customers given that the obligation on a bank to have 'due regard to the interests of its customers and treat them fairly'[1442] fails to adequately protect the bank customer.[1443]

Furthermore, it is argued that the banking system is any economy's backbone and is built on such principles as integrity, trust and loyalty. Its existence is jeopardised without them.[1444] Banks are repositioning themselves as advisors rather than mere execution or transactional service providers. Establishment of long-term relationships, placing customers' interests first and trust and confidence are all mentioned frequently in private banking promotional literature. Regulators often employ similar fiduciary terminology.[1445]

[1439] Plato-Shinar (n 1422) 216.
[1440] John Kay, 'The Kay Review of UK Equity Markets and Long-Term Decision Making, Final Report, July 2012' <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/253454/bis-12-917-kay-review-of-equity-markets-final-report.pdf> accessed 24 June 2022.
[1441] Law Commission, 'Fiduciary Duty of Investment Intermediaries' (2014) <www.lawcom.gov.uk/wp-content/uploads/2015/03/lc350_fiduciary_duties.pdf> accessed 24 June 2022.
[1442] FCA Handbook, PRIN 2.1.1(6).
[1443] Law Commission, 'Banks' duties to customers' <www.lawcom.gov.uk/banks-duties-to-customers/> accessed 24 June 2022.
[1444] Plato-Shinar (n 1422) 220.
[1445] Sui Tong Chua, 'The private banker as fiduciary' (2015) 30(5) Journal of International Banking and Financial Law 295.

7.2.2 A statutory general fiduciary duty for banks

The chapter argues that a fiduciary duty should be imposed on banks by statute. This proposal builds upon the successful experience of Israeli law in this area. Indeed, banks' fiduciary duty to their customers is well established in Israeli case law. The English equitable notion of fiduciary duty was adopted and developed upon by Israeli courts, which viewed the notion as a valuable and justifiable instrument. They applied it in numerous cases, moulding it to fit their societal perceptions. Hence, the bank's fiduciary duty came to be a cornerstone of Israeli banking law and a critical tool for customer protection.[1446] The Israeli courts aimed mainly to prohibit banks from exploiting customers' weaker position. The Israeli courts were prepared to impose a fiduciary duty on banks due to customers' weaker position, trust and reliance on banks' advice, banks' control over customers' financial assets and economic interests, and legal policy, that is, banks' activities were deemed to have the features of an essential service to the public. The Israeli courts conceive banks to be quasi-public bodies and require them to have a heightened level of conduct.[1447]

It is recommended that the new duty should be enforceable by the court and provide a private right of action rather than simply regulatory enforcement by the FCA. It should be viewed as determining the legal relationship between banks and customers. The FCA cannot achieve that without legislation. The only feasible way would be for the FCA to advise government to enact an act that would create a fiduciary duty of a qualified nature that would change the bank-customer relationship. A special act which would give powers to the FCA to both supervise and enforce but also would effectively change the common law is required. Such an act establishing and implementing a statutory qualified fiduciary duty would create a new kind of fiduciary relationship and be fully actionable by the court. It would also be an action that bank customers can litigate. This would be necessary to harmonise regulation with private law because then, effectively, the private law position would become the same as the regulatory

[1446] Ruth Plato-Shinar, 'The Bank's Fiduciary Duty Under Israeli Law: Is There a Need to Transform it from an Equitable Principle into a Statutory Duty?' (2012) 41(3) Common Law World Review 219.
[1447] Ruth Plato-Shinar, 'The Banking Contract as a Special Contract: The Israeli Approach' (2013) 29(3) Touro Law Review 721.

position. This cannot be accomplished by the FCA. This must be carried out by Parliament. The FCA cannot change private law. The FCA can impose regulatory duties which are not private law duties. Notably, a statute would furnish an elaborate description of the conduct demanded.[1448] Obviously, the purpose of the statute would not be to replace all the common law that applies to the bank-customer relationship. It would be enacted for a specific scope, namely, to impose a fiduciary duty on banks and the related obligations. Thus, it would sit on top of the existing broader common law. It would complement private law and financial regulation.

7.2.3 The nature of the new statutory fiduciary duty

It is argued that the new statutory duty which banks would owe to their customers would be a general fiduciary duty. Similar to Israeli practice, the bank's fiduciary duty would apply to the entire bank-customer relationship and the diverse services and activities which banks furnish to customers. The proposed fiduciary duty would be interpreted as the common law and equity principles on which it is based, and the new statute would affirm so. Case law conceives a fiduciary to be 'someone who has undertaken to act for and on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence'.[1449] The fiduciary relationship demands that the fiduciary subordinates their interests to those of the principal.[1450] Professor DeMott stated that 'the fiduciary's duties go beyond mere fairness and honesty: they oblige him to further the beneficiary's best interests'.[1451] The Law Commission held that power to act, discretion and vulnerability, which is intimately linked with information asymmetry, are found in a fiduciary relationship.[1452]

The new statute would state that the fiduciary duty would incorporate the following duties. It would provide that the bank would have to act with loyalty to the customer.

[1448] Keith Stanton (n 1419).
[1449] *Bristol & West Building Society v Mothew* [1998] Ch 1, 18.
[1450] Gerard McMeel, '"Every word you just said was wrong": holding banks to higher standards (Part One)' (n 1434).
[1451] D DeMott, 'Beyond Metaphor: an Analysis of Fiduciary Obligations' (1988) Duke Law Journal 879, 882.
[1452] Kay (n 1440) para 9.3.

A distinguishable feature ascribed to the fiduciary duty is loyalty.[1453] Breach of a fiduciary duty implies 'disloyalty or infidelity'.[1454] Thus, the bank would have to act honestly and loyally in relation to its customer. The loyalty duty expresses itself in prohibitive rules aimed to direct a fiduciary's behaviour.[1455] Hence, the statute would specify that the bank would have to act in the customer's best interests.[1456] Indeed, the bank would be guided solely by the customer's interests rather than by cognisance of its own interests.[1457] In fact, a fiduciary must protect and prioritise the latter's best interests over any other interest, including their own.[1458] The statute would state that the bank would be required to exercise good faith; not take advantage of the customer's trust; prevent conflicts of interest; and not act for its own or a third party's gain without the customer's informed consent.[1459] The bank would also have to retain the confidentiality of the customers' affairs.[1460] This aspect of the fiduciary duty would continue even after the bank-customer relationship's termination and customer's death[1461] except for legal compulsory disclosure. Thus, the proposed fiduciary duty would encourage ethical behaviour, ethics having been also advocated in previous chapters, primarily, Chapters Two (regarding freedom of contract and paternalism) and Four (regarding statutory consumer legislation).

In parallel to the aforementioned fiduciary duties, the statute would provide that a bank would have to exercise reasonable care and skill. It is acknowledged that, in itself, the fiduciary duty does not establish a standard of care, which is a separate concept. The fiduciary duty is an equitable principle whereas the duty of care is a common law one, as discussed in Chapters Three (concerning common law of contract) and Five (regarding tort law). A fiduciary duty on its own is insufficient. It is further recognised that, as discussed in Chapter Six (concerning the regulatory regime), a standard of

[1453] *Bristol & West Building Society v Mothew* [1998] Ch 1; Chua (n 1445).
[1454] *Bristol & West Building Society v Mothew* [1998] Ch 1; cited in this regard in *The Children's Investment Fund Foundation (UK) v Attorney General* [2017] EWHC 1379 (Ch) [142] (Vos C).
[1455] Chua (n 1445).
[1456] *Nehayan v Kent* [2018] EWHC 333 (Comm).
[1457] ibid.
[1458] Benjamin J Richardson, Fiduciary Law and Responsible Investing in Nature's Trust (Routledge 2015) 116-117; MacNeil (n 1424).
[1459] *Bristol & West Building Society v Mothew* [1998] Ch 1.
[1460] Hudson, *The Law of Finance* (n 1420) para 5.14.
[1461] Plato-Shinar, 'An Angel named "The Bank": The Bank's Fiduciary Duty as the Basic Theory in Israeli Banking Law' (2007) 36(1) Common Law World Review 27.

care is already provided by the FCA's regulatory rules but it is not actionable by consumers. What is actionable is the common law duty, which is less clear than the FCA one, hence, the benefit of the recommended statutory duty. The proposed legislation, which would introduce a fiduciary duty, would also codify a standard of care in line with these regulatory rules. Thus, the duty of care would complement the fiduciary duty and both may apply to the same context, for instance, the operation of savings and similar accounts, lending services and investment services.

Most importantly, and going beyond existing literature,[1462] it is proposed that the statutory fiduciary duty would encompass the duty to provide adequate advice. The imposition of a fiduciary duty would not suffice if there were no explicit duty to advise the customer. It is acknowledged that, as discussed in Chapter Three (regarding the common law of contract), traditionally, in equity, the duty to advise would be agreed contractually. Therefore, because one party gives advice to the other, the court would hold that the party who advises has fiduciary obligations. Hence, the fiduciary obligations would follow logically from a contractually agreed duty of advice. Furthermore, it is acknowledged that, as discussed in Chapter Five (concerning tort law), a tortious duty to advise may arise in certain circumstances. Thus, a duty to advise may arise contractually or tortiously but asserting it in a statute would broaden its scope and certify such a duty to advise.

It is acknowledged that, as discussed in Chapters Three and Five, when the bank opts to provide advice, either contractually or tortiously, the duty to furnish such advice with reasonable skill and care already exists. One fundamental difference between the current framework and the proposed statute/system is that the latter would introduce the duty of advice as a mandatory duty and would specifically state that such a duty would be required to be exercised with reasonable care and skill. Thus, the bank would not have a choice; instead it would be obliged to provide advice to the customer. This enhances legal certainty. The duty to advise would be a manifestation of the fiduciary duty and would be applicable to all important contracts with customers, particularly in the context of lending and investment.

[1462] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 1422).

It is argued that when a bank would have a statutory fiduciary duty incorporating a duty to provide advice, this means that when exercising this duty, the bank must have the customer's best interests, not the bank's interests in mind, and must furnish the advice with due skill, care and diligence. This signifies that the duty to advise would necessitate considering the customer's existing personal circumstances and, accordingly, provide tailored advice for an optimal outcome for the customer. The statute would clarify that the duty to advise is mandatory both at pre-sale and post-sale stages of the banking service. Thus, the duty would be valid both before and after the customer signs a contract with the bank. In this way, the fiduciary duty would assist in maintaining or improving the customer's welfare.

It is further claimed that such a fiduciary duty and duty of care would be heightened as the proposed statute would assert a presumption of negligence and, therefore, a reversal of the burden of proof. Rather than the customer having to demonstrate the bank's negligence, the bank would have to prove that it was not negligent, which, currently, is not the case. Admittedly, in English law, when there is breach of contract, strict liability applies and, hence, evidence of negligence is not required. However, in the case of breach of a duty of care and breach of a duty to advise with reasonable skill and care, whether contractual or tortious, the breach must be caused by negligence, not by innocent behaviour, and negligence must be proven. It is argued that, however, as a result of the proposed statute, the presumption of negligence would apply in circumstances where the customer would have suffered financial harm, or detriment, consequent to their relationship with the bank. These circumstances would, essentially comprise the duty to exercise reasonable skill and care in the operation of savings and similar accounts, and in the specific contexts of the duty to advise, which, as aforementioned, would apply to all significant contracts, particularly lending and investment services.

Thus, it is acknowledged that common law already establishes that the duty of advice must be carried out with due diligence, that is, with reasonable skill and care. As a result of the proposed statute, whenever the bank would advise a customer, and the bank would have to advise because such a duty would be compulsory as part of the

fiduciary duty, if the bank would breach its duty of care and provide negligent advice which would cause harm to the customer, insofar as the latter could prove their loss, then the bank would have to rebut the presumption of negligence, to prove that the advice was not negligent. Thus, the bank's advice would be presumed negligent and the customer would not have to prove that such advice breached the standard of care. Therefore, another main distinction between the current framework and the proposed statute/system/legislation is that the latter imposes a presumption of negligence and a reversal of the burden of proof in the customer's favour.

This is important for the customer because it would be easier for them to institute legal proceedings against the bank for lack of advice or negligent advice as costs would be reduced and there would be a great chance of success. The presumption of negligence and reversal of burden of proof are not unprecedented in English law. Section 40 of the Health and Safety at Work Act 1974 does impose such a reversal of the burden of proof. It provides that when a duty bearer is obliged to perform something as far as is practicable or reasonably practical, the burden shifts to the defendant to prove that it was not practicable or reasonably practicable to perform more than was actually carried out. According to the Court of Appeal in *R v Davies*,[1463] such a burden of proof is a lawful burden which is justifiable, essential and proportional. It is argued that such a statement is equally legitimate in the context of the bank-customer relationship. The proposal made is also consistent with the approach taken in European Law, specifically, in article 11 of Directive (EU) 2019/771 on certain features of contracts for the sale of goods.[1464] This article holds that when a sales contract concerns the ongoing provision of goods with a digital content or digital services over a period of time, the seller bears the burden of proof as to whether the digital content or service was in conformity within such period of time.

The proposed fiduciary duty would not compel banks to disregard their financial interests.[1465] A commercial relationship does not inevitably preclude that it is a

[1463] *R v Davies* [2002] EWCA Crim 2949.
[1464] Directive (EU) 2019/771 of the European Parliament and of the Council of 20 May 2019 on certain aspects concerning contracts for the sale of goods, amending Regulation (EU) 2017/2394 and Directive 2009/22/EC, and repealing Directive 1999/44/EC [2019] OJ L136/28.
[1465] ibid 219.

fiduciary too. Commercial characteristics have been implicated to numerous status-based fiduciary relationships.[1466] The duty would allow banks to be reasonably remunerated for their services. However, it would prevent banks from profiting from the performance of obligations without the customer's informed consent.[1467] It is claimed that the time has come to proceed towards a fiduciary ethos 'where service providers place a premium on treating clients fairly and where the goal is to win with clients rather than win against them'.[1468]

The proposed statute would indicate that, in contrast to English common law but same as Israeli case law, courts would deem the bank-customer relationship to be fiduciary from its establishment to its termination. Similar to what Israeli courts do, the statute would also provide that English courts would consider the legal policy of banks as quasi-public bodies providing essential services and the overarching circumstances of the bank-customer relationship, and not focus solely on the specific issue in front of them.[1469]

Further, waivers of the fiduciary duty have been suggested in the literature.[1470] However, this possibility is rejected because it is argued that waivers weaken the protection afforded by the duty. If waivers are available, the bank will force the customer to waive the duty. It would end up being a tick-box exercise as has occurred with the doctrine of undue influence. The logic of the argument behind the proposal calls to state that the fiduciary duty should be mandatory and not waivable. Perhaps one possible exception could be made. Certain elements of the fiduciary duty could be permitted to be waived if the customer is a high net worth individual or very sophisticated, both terms requiring to be defined for legal certainty. Yet, the fiduciary duty would not be completely waived.

[1466] See *United Dominion Corporation Ltd v Brian Pty Ltd* (1985) 157 CLR 1; *Tate v Williamson* (1866) LR 2 Ch App 55; *In re Coomber; Coomber v Coomber* [1911] 1 Ch 723; Chua (n 1430).
[1467] *Bristol & West Building Society v Mothew* [1998] Ch 1; *Henderson v Merrett Syndicates* [1995] 2 AC 145; Kay (n 1440) para 9.6.
[1468] D Sarro and E Waitzer E, 'Fiduciary Society Unleashed: The Road Ahead for the Financial Sector' (2014) 69(4) Business Lawyer 1081, 1098.
[1469] Ruth Plato-Shinar, *Banking Regulation in Israel: Prudential Regulation versus Consumer Protection* (Wolters Kluwer 2016) para 40-4.
[1470] Plato-Shinar, 'Law and ethics: the bank's fiduciary duty towards retail customers' (n 1422) 235.

7.2.4 Provision of private and regulatory enforcement of statutory duty

The logic of the proposal made requires that the new statute would provide for double enforcement of the fiduciary duty, that is, through private enforcement and regulatory enforcement. One way of private enforcement is through the institution of proceedings in the courts by the customers, that is, the statute would furnish a private right of action to customers. The statute would also empower the FCA to be able to intervene in such litigation to support the customer if it so wishes. Moreover, the statute would also provide for the possibility of the FCA to bring class actions on behalf of customers like the OFT did in the past in the case of Abbey National. This would be private litigation through a consumer body.

In this regard, it is claimed that while the FCA's authority to enforce the fiduciary duty within the regulatory framework would be a divergence from its typical function to enforce the regulatory regime, the Australian Securities and Investment Commission (ASIC) already has similar powers. Indeed, the ASIC has extensive enforcement powers; it can enforce investor rights and take action for breach of fiduciary duty that falls within its wide regulatory scope.[1471] The statute would also enable customers to institute a class action on their own should the FCA disagree. On top of that, certainly, the statute would provide that the FCA itself would be empowered to impose penalties, fines and sanctions for breach of the fiduciary duty.

7.2.5 Provision of *ex ante* and *ex post* protection by the fiduciary duty

The two main areas where bank customers' interests are mostly at risk are credit and investment. In the current framework, it is argued that *ex ante* protection is provided

[1471] Helen Bird, Davin Chow, Jarrod Lenne and Ian Ramsay, 'ASIC Enforcement Patterns. University of Melbourne, Public Law Research Paper No 71' (27 April 2004) <www.ssrn.com/abstract=530383> accessed 20 May 2022.

in limited circumscribed ways. For instance, in relation to lending, a bank is obliged to assess affordability, but it does not need to assess holistically whether advancing the credit is in the customer's interests. Similarly, in regard to investment, a bank has a duty to exercise reasonable skill and care and to provide suitable advice when it does advise the customer, but it does not have to advise the customer. Moreover, a bank only provides advise when the customer pays for it.

It is argued that the fiduciary duty would provide the level of protection desired because it would apply in *ex ante* and *ex post* contexts. Importantly, it would fill in the gaps of *ex post* review of contracts and bank customer welfare. Also, particularly, a fiduciary duty with an advice element will overcome the problems of fragmentation of protection, undue focus on customer responsibility, banking practice and inadequacy of *ex post* care. Thus, in relation to lending, for instance, if a customer would like to take a loan from a bank, in an *ex ante* context, the fiduciary duty would oblige the bank to advise them whether the loan is adequate for them or not. In an *ex post* context, if the bank has provided the loan to the customer and, subsequently, after a certain lapse of time, the customer's situation changes and they cannot repay the loan, the fiduciary duty would compel the bank to give the customer a fair opportunity, to do a restructuring and rework the debt.

In regard to investment, in an *ex ante* context, the fiduciary duty would oblige the bank to provide suitable advice to invest the money in, for instance, a specific fund. In an *ex post* context, in the event that after a certain lapse of time, the customer's circumstances change and the fund is not good for them anymore because their situation is different, the fiduciary duty would oblige the bank to advise them to change the investment. In the context of savings, the fiduciary duty would require the bank to advise the customer to move them out of that account into a better account.

Thus, the statutory fiduciary duty proposed would provide adequate *ex ante* and *ex post* protection because it would assist bank customers both in the pre-sale and post-sale stages of banking services. It would address the advice gap for customers who are unable to pay for advice, let alone holistic ongoing advice. It would eliminate the

advice affordability problem because banks would be obliged to provide tailored advice in accordance with customers' existing needs. Mere generic or automated advice would be unsatisfactory and would fall foul of this obligation. The fiduciary duty would also address the post-sale care gap because banks would be obliged to provide post-sale care and conduct a periodic review for customers even in the absence of portfolio management or express agreement with banks. Moreover, in imposing post-sale care and ongoing advice, the fiduciary duty would address the financial welfare outcomes gap. It would address the fact that customers remain so beyond point of purchase and the fact that banking services are credence goods whose welfare outcomes would be revealed over time. Customers may need to review banking services and contracts due to life-changing events or may continually require taking decisions in relation to certain services, for instance, investment. These decisions may have enormous negative consequences on customers' financial welfare.

Contrastingly, the current system furnishes more *ex ante* protection than *ex post* protection. Further, this *ex ante* protection is practically provided by regulatory rules rather than rules that are actionable in court. The principle that the loan must be affordable is a regulatory principle. If the customer institutes proceedings in court and claims that they cannot repay the loan because it is not affordable (either from the beginning or thereafter due to a change in the customer's circumstances), as matters currently stand, their action will fail. There is nothing in private law which obliges the bank to assess whether the customer can or cannot afford the loan because it is a non-fiduciary, commercial relationship from a private law perspective. The customer would lose such litigation. It has already been emphasised in Chapter Six that, although certain judges do consider regulatory rules before passing judgment, the reality is that many others tend to disregard them and pass judgment in accordance with principles of common law only. On the other hand, if the customer seeks a remedy through the FOS, it is likely that the latter will favour the customer and deliver an equity-based decision, thus concluding that they must repay the capital but they will not be required to pay the accrued interest. Were the proposed statute to be implemented, the customer would be able to seek and attain the same or stronger remedy through the court instead of the FOS, which could include the repayment by the bank of any interest paid already by the customer.

In the current system, there have been many cases where customers were not able to repay the loan and complained to the FOS. Using the regulations which hold that customers have to afford the loan for the bank to give them the loan, the FOS decreed that they had to pay only the capital without any interest. Therefore, it may be argued that the proposal is useless because bank customers may revert to the FOS. It is argued that, however, the major pitfall with the FOS is the lack of precedent. The FOS's decision is binding but it does not generate precedent. The FOS functions very much on a case-by-case basis. The FOS would decide every case on its own merits and on fair, just and equitable principles, extending further than private law and regulatory rules.[1472] There is no clarity for the next customer. There are all shades of grey as to whether the FOS would decide that the bank was unfair in giving the loan or not. Additionally, the FOS cannot grant a remedy greater than GBP 355,000 although this normally suffices for matters relevant to the ordinary bank customers. In having the new statute in place, if the court were to determine those issues, the courts would be generating binding precedent thereupon. Moreover, it is possible that, in the presence of a statutory fiduciary duty, the court might go further than the FOS in remedies when finding in favour of the customer. Hence, in this manner, the fiduciary duty also addresses the *ex post* redress gap.

It should be emphasised that the importance of the FOS, which is an alternative dispute resolution is not being minimised. Currently, the FOS is the best option for bank customers and the main method for a customer in the UK to obtain a remedy if they are unhappy with the way the bank has treated them. It is not the FCA. The FCA does not hear complaints from customers. The FCA supervises and may impose sanctions, penalties and fines on banks. It is not the court because if the customer goes to court it is highly likely that the customer will lose, simply because the court decides on established private law concepts, especially freedom of contract and autonomy. Therefore, the customer's only hope is the FOS if they feel aggrieved that the bank has mistreated them. In fact, this is the main reason for the FOS having hundreds of thousands of cases every year. Sometimes the FOS finds for the customer, sometimes for the bank. It is also highlighted that, if the proposal being

[1472] MacNeil (n 1424).

made were to be implemented, the FOS could be guided by the development of precedent of case law through the litigation on the fiduciary duty and become more predictable as well rather than the FOS deciding only on fair, just and equitable standards. It would serve both sides, the customer and the bank, to have predictability. Hence, the FOS's important role in enhancing conduct standards would not be endangered by a statutory fiduciary duty.[1473]

7.2.6 Another possible solution

Instead of legislation, an alternative could be for the FCA to introduce this kind of fiduciary duty and make it actionable through section 138D of FSMA. However, this is not good enough because legislation increases publicity, legitimacy and is more realistic. Most of all, it provides legal certainty. Also, the FCA is unlikely to do that of its own accord but, on the other hand, if the FCA is convinced and Parliament is not, it could be an alternative. Therefore, in a way, although preference is for a statutory fiduciary duty, admittedly, at least, there is an alternative route.

This is possible because the FCA can include and exclude actionability under section 138D(2) but it cannot change private law. If it makes regulatory rules that impose a fiduciary duty and provides that such rules fall within the remit of private action, giving a private right of action, then the bank customer can bring civil litigation for breach of that fiduciary duty. Effectively, in practice but not in theory, it would have the same result as if private law had been changed. However, this a little too activist for the FCA to do. Therefore, it is more realistic to propose legislation because without legislation and without Parliament legitimising such a fiduciary duty, it would be really unlikely that such a duty would be imposed on banks. Hence, legislation would effectively do that.

[1473] ibid.

7.3 Rebutting counterarguments against synthesis of private law and regulation

This section attempts to pre-empt counterarguments to the proposal being made and to rebut such arguments. Possible counterarguments identified are the following: the current framework of two separate systems of private law and financial regulation is effective; a synthesis of private law and financial regulation is radical; a more activist FCA would be sufficient; it would make banking services too costly; the new fiduciary duty would slow down transactions; and the reform would not change much in practice because customers might find the private law remedies too slow or inaccessible.

7.3.1 Current framework of two separate systems of private law and financial regulation is effective

It may be argued that the current framework works well as a result of FCA enforcement and the FOS. Therefore, it may be queried why it is essential to merge the two systems of private law and financial regulation instead of keeping them separate as they currently are. While it is acknowledged that no definitive answer can be provided to those who advocate absolute freedom of contract and contract law's primacy,[1474] and that the proposal of a statutory fiduciary duty is in a way undermining the autonomy of private law, it is argued that the current framework of two separate systems of private law and financial regulation is not equally effective. This is due to the pitfalls in private law and financial regulation, including the new Consumer Duty, as already discussed in the previous chapters. Particularly, bank customers who suffer loss consequent to a breach of the FCA's Principles, including the new Consumer Duty, have no right of action against the bank for such breach under section 138D of the FSMA.[1475]

[1474] Gerard McMeel, '"Every word you just said was wrong": holding banks to higher standards (Part One)' (n 1434).
[1475] FCA Handbook PRIN 3.4.4R and PRIN Schedule 5.

If none of the Principles, including the new Consumer Duty, are actionable privately, the only person who can enforce them is the FCA itself. However, the FCA cannot be trusted to do this. The FCA has limited resources and struggles to have expertise, which is captured by the industry. In fact, the FCA itself has confirmed that potential harm identification does not necessarily signify that it will take action and that its restricted resources oblige it to prioritise the instances where it will do so, namely, where it considers there is the greatest harm. Thus, it acts to protect the most vulnerable and least resilient consumers[1476] and not all consumers.

The FCA itself admitted that a new framework for ongoing emergence of UK retail markets and expectations over and above its current Principles and rules is necessary.[1477] In fact, it intends to introduce a new Consumer Duty as part of the Principles, which are not actionable privately. Therefore, the current situation will not effectively change because if the new Consumer Duty is breached by banks, consumers cannot take private action for breach thereof to seek compensation for the harm suffered.

7.3.2 Proposal is too radical to fit well in the English legal system

It may be argued that what is being proposed may be radical. However, in response, it is argued that, while the proposal being made may sound radical, it is not a precedent because it is in a way already happening. It is enhancing a movement which is already present in case law.[1478] Sometimes, not always and to a certain extent, courts are already taking cognisance of regulatory rules when making decisions, for instance, to decide on what constitutes reasonable and honest conduct or to decide whether a firm should be held to owe a duty of reasonable care and skill to its customer. This

[1476] FCA, 'FCA Mission: Approach to Consumers' (July 2018) 30 <www.fca.org.uk/publication/corporate/approach-to-consumers.pdf> accessed 23 June 2022.
[1477] ibid.
[1478] Eg *Bankers Trust International plc v PT Dharmala Sakti Sejahetra (No. 2)* [1996] CLC 252; *Heinl v Jyske Bank (Gibraltar) Ltd* [1999] Lloyd's Rep Bank 511, 535 (Colman J); *Sphere Drake Insurance ltd v Euro International Underwriting Ltd* [2003] EWHC 1636 (Comm); *Investors Compensation Scheme Ltd v West Bromwich BS* [1999] Lloyd's Rep PN 496; *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184.

illustrates that some judges appreciate the need for a more coherent approach. However, given that only some judges have considered the FCA's regulatory rules and only in some contexts, it is much more adequate to obtain a coherent system of finance law in the manner it is being proposed, namely through primary legislation, which would impose a general fiduciary duty on banks to customers, which duty would, in turn, comprise various obligations. These duties would be enforceable both through a private right of action of the customer and through regulatory action. This will bring together private law and regulation. Having legislation which would directly put forward in statute a fiduciary duty and other responsibilities to ensure that banks need to prioritise customers' interests and welfare, then it would go further than the courts have gone so far.

Further, the proposal and argument being made resonates with measures taken in other areas. Such areas have seen broad legislative intervention that has superseded much of the common law. For instance, the Unfair Contract Terms Act, now replaced by the CRA, which was targeted at particular unlawful conduct in consumer contracts, undertook a paternalistic function and furnished more clarity than the strict common law penalty rule. In fact, this common law rule currently only has a secondary, supportive function, primarily to act when legislation does not intervene.[1479]

7.3.3 A more activist FCA would suffice to resolve existing problems

While it may be accepted that the current system does not provide sufficient protection, it may be argued that a better solution than what is being proposed is provided through regulation. It may be contended that what is needed is a more activist FCA, that what is required is the FCA to be more ardent in enforcing regulatory duties, without changing private law and without introducing private enforcement and litigation. It may be further argued that it would be better to rely exclusively on public enforcement by the FCA so that it would be more effective, simpler and better for coherence of private

[1479] Man Yip and Yihan Goh, 'Convergence between Australian common law and English common law: The rule against penalties in the age of freedom of contract' (2017) 46(1) Common Law World Review 61.

law to resolve these purely through public law. It may be argued that if regulatory enforcement is not functioning well, it is better to make it function well rather than what is being proposed. It may be argued that by keeping the two areas separate – the regulatory law from private law – the clarity and simplicity of private law and, therefore, the coherence of private law will be maintained.

An alternative would be for the FCA itself to make applications to the court. Pursuant to section 382 of FSMA, the FCA is empowered to file an application in court to obtain a restitution order from banks. Additionally, it may exercise its administrative power to necessitate restitution under section 384 of FSMA. In determining whether to utilise such powers, the FCA will assess whether this would be the best option given its restricted resources. Therefore, this alternative is rather ineffective because the FCA will rarely exercise such formal restitution order powers.[1480]

However, it is argued that the proposed approach is better than relying on the FCA to be more activist and use its enforcement power or power to apply to the court. It is questionable whether it is realistic that the regulator on its own without any pressure from the courts can resolve the matter. Given regulation's limitations, it is irrational to rely exclusively on public enforcement. In the proposal made, the importance of public enforcement is recognised and would be present. It is just that it would not be the only enforcement because it is not enough. Hence, it is advocated that it is better to have both public and private enforcement rather than only public enforcement. In other words, private enforcement will complement public enforcement.[1481] Private enforcement will also complement the FOS which is a form of public service, an alternative dispute resolution rather than enforcement.

Additionally, it is worth noting that, ultimately, common law has developed in the way it has because court actions have always been brought by sophisticated customers,

[1480] FCA, 'Enforcement Guide: Chapter 11: Restitution and Redress' (June 2022) EG 11.1.3 <www.handbook.fca.org.uk/handbook/EG/11.pdf> accessed 24 June 2022.
[1481] see John Armour, Bernard Black, Brian Cheffins and Richard Nolan, 'Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States' (2009) 6 (4) Journal of Empirical Legal Studies 687.

or large companies. It is claimed that English contract law has evolved through a series of cases, the vast majority of which have been commercial in nature. This is most likely because commercial parties have the financial wherewithal to litigate. Thus, English contract law reflects in a way business-to-business commercial contracts. Therefore, common law has never had the opportunity to develop in another direction because cases involving weaker parties have never reached the courts. The proposed system would allow for private litigation which would have the positive impact of enhancing and developing common law, even beyond banking law, by assisting the courts in formulating good principles for dealing with circumstances where one party is weaker than the other.

7.3.4 The reform would make banking services costly and exclude certain customers

It may be argued that if a statutory fiduciary duty, including the duty to advise, would be imposed, banks would be very defensive and would make banking services costlier with the possibility of exclusion of some customers. In response, it is argued that public law is an option to address problems of exclusion. Under the relevant legislation, private utility companies are obliged to offer their full service to everyone.[1482] While it is acknowledged that this would lead to wealth redistribution, it is claimed that a narrow redistribution rationale is permissible due to the semi-state nature of the banking sector. As discussed in Chapter Two, whereas paternalism is the primary purpose and should permeate the entirety of the proposed new approach to the law, wealth redistributive policies are acceptable in specific contexts. As also discussed in Chapter Two, one such context is precisely where there is the risk of financial exclusion of customers. Hence, redistributive policies are limitedly needed in these circumstances to ensure avoidance of such financial exclusion of customers. It is therefore further argued that public law would be required to oblige banks, similarly to companies offering public utilities, to offer basic services to all customers (excluding lawful, legitimate reasons, for instance, relating to money laundering and terrorism) even when it would not be so profitable for them to do so. Without this public duty to

[1482] eg Electricity Act 1989, s 16; Water Industry Act 1991, s 45.

provide banking services, the proposal made could lead to exclusion of certain customers. It is left open for future research to assess whether this would be appropriate.

Moreover, it may be argued that the duty to advise and the other fiduciary duties would increase the legal risk for banks. Therefore, banks would have an incentive to not deal with, and, particularly to not lend to, certain customers. Hence, there could be the possibility that customers would have less availability of loans. Thus, the proposal made may restrict access to credit for certain consumers and again lead to their exclusion. It may be further contended that this would be a problem as such consumers could, consequently, suffer detriment. For instance, they could be prohibited from starting a small business or finding employment. Furthermore, the economy could suffer if more serious problems would emerge, for instance, they would end up homeless.

However, it is argued that this is not necessarily the case when there is a mix of welfare and excessive debt. Effectively, in the UK, there is use of excessive lending to substitute for lack of social welfare. Reduction of loan availability already occurred when the FCA imposed a cap, or maximum limit, on interest on short-term payday lenders. As the FCA admitted, this restricted access to credit for the poorest of consumers, who were thus excluded. Therefore, in a way, there is precedent in regulation that leads to the exclusion of some consumers. It does not necessarily mean that the exclusion of some is always a bad consequence because it could be that the banking service is inappropriate for them. The solution to social problems should not be the provision of loans by banks to customers who cannot afford them. It is argued that financial law should be complemented by appropriate social welfare provisions, which obviously fall beyond the scope of this thesis, and, therefore, should be dealt with elsewhere. Hence, although in principle, reduction of loan availability appears to be a problem, in practice, it is not.

Further, currently, banks already have an affordability requirement. However, they have no obligation to assess whether the loan is appropriate for the customer in their

existing circumstances and whether other better solutions are available for the customer, and discuss all this with them in a paternalistic way. Thus, when an over-indebted customer approaches a bank to take a loan to pay off existing debts, while the loan may be technically affordable, it may be inferior to another option, for instance, personal bankruptcy.[1483] Yet, the bank has no obligation to make the customer aware that making themselves bankrupt may be a better option than taking another loan. Contrastingly, in having a fiduciary duty towards the customer, including the duty to advise, the bank would be required to act in the customer's best interests and would be compelled to provide advice to the customer and recommend optimal alternatives, including personal bankruptcy. Moreover, if, for instance a customer has a mortgage on a house, which is destroyed and, for some reason, the house insurance is invalid, the customer may, effectively, become bankrupt. In this situation, the bank may also advise that the best option is to file for personal bankruptcy, taking cognisance of the customer's existing situation holistically.

Thus, a bank customer may file a bankruptcy application to an adjudicator if they are unable to pay their debts. The application will in fact be reviewed by the adjudicator, who is an employee of the Insolvency Service. The adjudicator will decide to issue a bankruptcy order if four criteria are satisfied, namely, the adjudicator had authority to decide the application on the day it was filed; the debtor is incapable of paying their debts at the determination date; there is no pending bankruptcy petition against the debtor at the determination date; and a bankruptcy order has not been issued in relation to any debt mentioned in the application. If the adjudicator decides for bankruptcy, the customer will receive a bankruptcy order. On being declared bankrupt, their assets can be utilised to pay their debts, the customer must follow certain restrictions, for instance, they cannot borrow more than GBP 500 unless they inform the lender that they are bankrupt, and their name and details will be listed in the Individual Insolvency Register. The customer is normally released, or discharged, from their debts after twelve months, albeit assets which formed part of their estate

[1483] Katharina Moser, Jodi Gardner and Mia Gray (eds), *Debt and Austerity – Implications of the Financial Crisis* (Edward Elgar Publishing Ltd 2020).

during the bankruptcy period can still be employed to pay their debts.[1484] In this manner, the customer has the possibility to start their life afresh. The customer may also make an application to the official receiver via an authorised intermediary to attain a debt relief order instead. Certain eligibility criteria, for instance, the customer owes less than GBP 30,000, apply.[1485]

In this regard, it is suggested that reforms are necessary for these two types of non-consensual individual insolvency procedures to be more efficient. Indeed, it has been claimed that such reforms may include removal of financial barriers and policy changes which would mitigate against consumer biases and favour the adoption of these non-consensual solutions over consensual individual voluntary arrangements between the debtor and their creditors.[1486] Obviously, more efficient bankruptcy proceedings would assist bank customers.

It is further argued that bankruptcy law is not enough to protect customers and is indeed a last resort option. Contrastingly, the fiduciary duty is valuable to help prevent customers ending up needing to go through bankruptcy. For instance, in a situation where a customer is unable to pay their mortgage for one reason or another, the bank should typically advise the customer to sell the house before accruing interest and charges, so that the customer can obtain the highest value out of their equity in the house. If they do not, the situation will deteriorate, and interest will begin to accumulate. The bank will eventually sell the residence, leaving the customer impoverished and possibly, bankrupt. It is acknowledged that the MCOB rules do require banks to provide an alternative remedy to property possession, but they may not necessarily furnish the best option. It is argued that the imposition of a fiduciary duty on banks would require the bank to advise the customer on the best course of action, which may be to sell the house quickly so that the customer does not lose equity and end up bankrupt. This, however, is contingent on the customer's

[1484] see Insolvency Act 1986, sections 263H-O; Joseph Spooner, *Bankruptcy: The Case for Relief in an Economy of Debt* (Cambridge University Press 2019).
[1485] See Insolvency Act 1986, sections 251A-X.
[1486] Katharina Moser, 'Making sense of the numbers: The shift from non-consensual to consensual debt relief and the construction of the consumer debtor' (2019) 46(2) Journal of Law and Society 240.

circumstances, such as their capacity to locate alternate sources of income in the medium term and their ability to find alternative housing, which can be difficult. Indeed, it would be time consuming for banks to have to fully comprehend the customer's situation. In this regard, it is claimed that it is therefore unsurprising that banks would be hostile to the imposition of a fiduciary duty and a mandatory duty to advise and, instead, prefer a straightforward affordability assessment because it is quicker and easier.

7.3.5 The new fiduciary duty would slow down transactions

It may be argued that a new private law fiduciary duty would slow down transactions. However, it is counterargued that a fiduciary duty would primarily be required in the context of the provision of mortgages, loans and investments. Hence, it would not slow down such transactions as deposit or withdrawal of money from bank accounts. In respect of the fiduciary duty relating to the provision of mortgages, loans and investments, banks are already obliged to obtain information, including financial resources, from customers pursuant to the FCA's affordability, suitability and appropriateness rules, and know-your customer anti-money laundering and anti-terrorism requirements. Therefore, the additional time which the fiduciary duty would necessitate would be for banks to understand the customer's current situation, examine whether the mortgage, loan or investment would be in the customer's best interests and advise accordingly.

It is further contended that a fiduciary duty in such circumstances may ultimately benefit banks too because, after all, it would also be in their interests that their customers fare well and adhere to their obligations for banks to be able to recoup their money and make and continue making profits from interests on money lent and fees for services rendered. If customers default and remain so, banks would eventually have to expend time and resources, and incur costs to recover their money through various communications with customers and, if these efforts would prove unsuccessful, through legal proceedings.

7.3.6 The reform would not change much in practice because the private law remedies would be too slow or inaccessible

Finally, it may be argued that the new system would not change much in practice because customers might find the private law remedies, that is, court proceedings, too slow or inaccessible. In reply, it is argued that while even the FOS procedure takes its own time, if courts' human resources are increased and judges and customers' lawyers perform their tasks efficiently and effectively, then the private law remedies would not be overly slow or would not be slow at all. Furthermore, once a few cases are decided and the law is reasonably clear, most disputes will be settled without going to court quickly and efficiently.

In relation to accessibility, it is argued that the proposed primary legislation would ascertain that customers would have a private right of action to sue banks in breach of the new statutory fiduciary duty and would make it as easy, or as least burdensome, as possible for customers with meritorious claims to institute court proceedings and be successful. With respect to accessibility in terms of financial resources, it is argued that the mode of implementation discussed in the following section would ensure that private law remedies would be accessible to all, or at least to most, customers with meritorious claims.

7.4 Implementation of the statutory fiduciary duty

If a statutory fiduciary duty is made available to customers that they can action and take banks to court for breach of that duty, ways and means must be provided to the customers to be able to do so. Therefore, this section discusses how the private right of action would be implemented in practice, that is, how customers would manage to bring litigation, how customers will pay for it. Thus, this section addresses the cost aspect of the private right of action, the million-dollar question in law.

It is acknowledged that simply introducing any duty in legislation would provide in itself very limited protection to bank customers because it is highly probable that they do not have the money to litigate. If only a private right of action is supplied to customers, in practice, they will not use it because the very few expert solicitors in financial services in the UK are extremely expensive and will not risk taking over the case because if they lose the case, they will burden the customer with hefty litigation costs. Many times, this will bankrupt an ordinary individual customer.

Addressing the cost issue is important because if customers cannot litigate, then, even if this act of Parliament would be passed, it would be cosmetic and would not be an effective remedy but rather purely symbolic. It would only be up to the FCA to impose sanctions, fines and penalties and no progress would effectively be made. The situation would remain similar to the status quo. The FCA can already impose these if it wants to. The FCA is not bound by contract law. The FCA can find that the banks are behaving unfairly in all relevant contexts. The FCA can protect customers more but, given its limited resources and regulatory arbitrage, this is not feasible. Therefore, it is crucial to find ways and means such that private enforcement of the fiduciary duty on top of regulatory enforcement is made possible given the lack of customers' financial resources. The answer is public funding of individual cases, test cases and/or class actions. For this to happen, legislation which would allow the FCA to fund litigation is necessary.

The current position includes different options for covering litigation costs in the UK: contingency fee agreements with lawyers, financial markets test case schemes, class actions and third-party funding. A different approach to class actions is taken in Israel. This section explores these options and argues that the best option for the purposes of the proposal is the Israeli approach with some adaptations.

7.4.1 Contingency fee agreements

Customers can take advantage of contingency fee agreements, which are a type of financing offered by English lawyers pursuant to the Courts and Legal Services Act 1990. Conditional fee agreements (CFAs)[1487] and damages-based agreements (DBAs)[1488] are the two forms. A CFA is an agreement between a customer and a lawyer wherein the latter consents not to charge any fee or charges a reduced fee if the lawsuit is lost, and the customer consents to pay a standard fee – the 'base cost' – together with an additional fee – the success fee, which is a percentage of the base cost – if the lawsuit succeeds.[1489] A DBA, also known as a contingency fee agreement, is an agreement between a customer and a lawyer wherein the latter consents not to charge any fee if the case is lost and to obtain a percentage of the compensation if the case is won.[1490] In the US, contingency fee agreements are also available.[1491] If the lawsuit is successful, the lawyer is compensated from the money recovered. If the lawsuit is unsuccessful, the customer is not responsible for any legal fees. In the UK and US, legal fees for DBA are similar, ranging from around 30 percent to 50 percent of the amount paid to the customer.[1492] However, in the UK, the fees are capped at 50 percent[1493] whereas in the US, fees are not capped and, therefore, may charge much higher fees than 50 percent of the recovered compensation.

In both UK and US, it has been argued that contingency fee agreements improve access to legal assistance and courts by allowing customers who could not possibly pay counsel to posit their claims; incentivise lawyers to pursue customers' success; promote cost risk sharing by permitting customers to shift the risk of losing to the

[1487] Courts and Legal Services Act 1990, s 58.
[1488] Courts and Legal Services Act 1990, s 58AA.
[1489] Courts and Legal Services Act 1990, s 58.
[1490] Courts and Legal Services Act 1990, s 58AA.
[1491] American Bar Association, Model Rules of Professional Conduct, r 1.5(c) <www.americanbar.org/groups/professional_responsibility/publications/model_rules_of_professional_conduct/> accessed 24 June 2022.
[1492] Herbert Smith Freehills LLP, 'Contingency Fees or Damages-Based Agreements (DBAS)' (23 April 2021) <https://hsfnotes.com/litigation/jackson-reforms/contingency-fees-or-damages-based-agreements-dbas/>; American Bar Association, 'Fees and Expenses' (3 December 2020) <www.americanbar.org/groups/legal_services/milvets/aba_home_front/information_center/working_with_lawyer/fees_and_expenses/> accessed 24 June 2022.
[1493] Damages-Based Agreements Regulations 2013, SI 2013/609, r 4(3).

lawyer; and improve cost predictability by permitting customers to agree on terms regarding payment.[1494] In the US, contingency fee agreements have been criticised for encouraging numerous lawsuits; enticing lawyers to accept settlement quickly for a low compensation; and contingency fees being frequently excessive compared to the risk lawyers undertake in certain cases.[1495]

In the UK, CFAs have been reprimanded for costs' under-recovery in the sense that the portion of the lawyer's fee which is not recovered from the defendant has to be paid out of the customer's compensation; demotivation of lawyers to accept a case, accepting it only when they deem the agreed payment and success possibility make it worthwhile; payment of the defendant's expenses by customers when the lawsuit fails; and customers' cost of an 'after-the-event' insurance premium to mitigate against the risk of payment for the defendant's expenses, and their own disbursements, if the lawsuit is lost.[1496] Prior to 1 April 2013, the CFA success fee and ATE premium could be recovered from the defendant when the lawsuit succeeded. From that date onwards, they cannot be recovered even when the lawsuit succeeds.[1497] This has been disapproved of since it has made CFAs less appealing as they are not costless and risk-free anymore for customers.[1498] Indeed, this has been welcomed by defendants.[1499] It is suggested that, possibly, an exception for recoverability of the CFA success fee and ATE premium from the defendant could be made for smaller-value cases, such as those of bank customers, and where the defendant can easily afford such a burden.

[1494] Petra Arnold and Peter Stewart, 'UK: England Embraces Contingency Fees' (10 April 2013) <www.mondaq.com/uk/trials-appeals-compensation/268388/england-embraces-contingency-fees>; Curzon Green Solicitors, 'Contingency Fee Agreements' https://www.curzongreen.co.uk/practice_areas/contingency-fee-agreements/>; Cornell Law School, Legal Information Institute, Wex Definitions Team 'Contingency Fee' (May 2020) <www.law.cornell.edu/wex/contingency_fee> accessed 24 June 2022.
[1495] Cornell Law School, Legal Information Institute, Wex Definitions Team 'Contingency Fee' (May 2020) <www.law.cornell.edu/wex/contingency_fee> accessed 24 June 2022.
[1496] John Antell, 'The pros and cons of conditional fees and other ways of funding legal fees' (March 2021) <www.johnantell.co.uk/conditional-fees-and-other-means-of-funding> accessed 24 June 2022.
[1497] The Courts and Legal Services Act 1990, s58B.
[1498] Antell (n 1496).
[1499] Herbert Smith Freehills LLP, 'Conditional Fee Agreements (CFA) / After-the-event (ATE) Insurance' (2022) <https://hsfnotes.com/litigation/jackson-reforms/conditional-fee-agreements-cfas-after-the-event-ate-insurance/> accessed 24 June 2022.

Moreover, DBAs have been critiqued for absence of adequate payment for work completed upon termination; uncertainties surrounding early termination and the indemnity concept; concerns whether hybrid DBAs, which integrate a DBA and another type of retainer, for instance, hourly rates, are permissible;[1500] and issues of lack of transparency on the lawyer's fees when the DBA is officially concluded.[1501] It is argued that in the context of bank customer litigation, it is debatable whether, as in the US, the cap in the UK should be removed because this kind of litigation presents particular challenges, essentially, the relatively high fees charged by the few expert financial services lawyers, the higher risk of the lawsuit's failure and the relatively low compensation sought, all of which make it difficult for lawyers to be motivated to take on a case. It is also maintained that if the cap is removed, the net amount left in the customer's hands is equally problematic. In this regard, it has been observed that, notwithstanding considerable reprimand of the limitation, the government banned hybrid agreements as they could promote litigation on the basis of low risk/high reward strategy. The sluggish adoption of DBAs has been attributed to this phenomenon.[1502]

Thus, in order for DBAs to be more useful to bank customers, it is suggested that hybrid arrangements should be permitted whereby a lawyer could recover a limited fee, for instance, up to 30% of their non-recoverable fee and expenses, when the lawsuit fails. This would remove a signifcant barrier for the adoption of DBAs and give lawyers more flexibility in responding to customers' requests for alternate payment arrangements. It is further recommended that expenses should be recovered using the success fee model instead of the Ontario model, that is, both recoverable costs and the DBA percentage fee are reimbursed to the lawyer instead of the recoverable costs being discharged against the DBA payment. It is expected that this would render

[1500] In *Zuberi v Lexlaw Ltd* [2021] EWCA Civ 16, the Court of Appeal confirmed that the DBA Regulations do not in fact preclude terms providing for payment of time costs on termination, nor do they preclude hybrid arrangements.

[1501] Civil Justice Council, 'The Damages-Based Agreements Reform Project: Drafting and Policy Issues' (August 2015) <www.judiciary.uk/wp-content/uploads/2015/09/dba-reform-project-cjc-aug-2015.pdf>; Ministry of Justice, 'Post-Implementation Review of Part 2 of the Legal Aid, Sentencing and Punishment of Offenders Act 2012 (LASPO) Civil litigation funding and costs' (February 2019) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/777039/post-implementation-review-of-part-2-of-laspo.pdf> accessed 24 June 2022.

[1502] Civil Justice Council, 'CJC to look at Damages Based Agreements revisions' (10 November 2014) <www.judiciary.uk/related-offices-and-bodies/advisory-bodies/cjc/archive/civil-justice-council-cjc-to-look-at-damages-based-agreements-revisions/> accessed 24 June 2022.

DBAs more practicable in bank customers' smaller value lawsuits as well as eliminate the possibility of a surprise cost decrease for the defendant. Moreover, it is proposed that the lawyer and customer should have the ability to agree on payment conditions upon DBA termination, a matter which is unclear in the DBA Regulations.[1503]

Consequently, it is argued that while it is comprehensible that measures should be in place to prevent predatory solicitors from exploiting CFAs and DBAs and to avoid excessive litigation,[1504] such contingency fee agreements will be of little value to bank customers unless they are improved in some way both in terms of bank customers' accessibility thereto and in terms of lawyers' motivation to assist bank customers, who, typically, do not seek hefty compensation. Hence, it is argued that in the case of CFAs, the recoverability of the success fee and ATE premium from the defendant should be reintroduced. It is further argued that in the case of DBAs, a relaxation of the 50 percent cap, and/or the introduction of hybrid arrangements, success fee model and/or flexibility for lawyers regarding payment following DBA termination should be considered. It is thus contended that other possibilities which can assist bank customers in filing lawsuits should be investigated.

7.4.2 Financial Markets Test Case Scheme

Alternatively, the FCA can seek authoritative judgments by instituting a test case under the Financial Markets Test Case Scheme, which is governed by CPR PD 63AA of the Civil Procedure Rules and Practice Directions.[1505] The scheme is applicable to claims,

[1503] Rachael Mulheron and Nicholas Bacon, 'Damages-based agreements (DBAs): promising proposals for reform' (18 October 2019) <https://hsfnotes.com/litigation/2019/10/18/damages-based-agreements-dbas-promising-proposals-for-reform/> accessed 24 June 2022.

[1504] Right Honourable Lord Justice Jackson, 'Review of Civil Litigation Costs: Final Report' (December 2009) <www.judiciary.uk/wp-content/uploads/JCO/Documents/Reports/jackson-final-report-140110.pdf.>; Right Honourable Lord Justice Jackson, 'Review of Civil Litigation Costs: Supplemental Report, Fixed Recoverable Costs' (July 2017) <www.judiciary.uk/wp-content/uploads/2017/07/fixed-recoverable-costs-supplemental-report-online-3.pdf> accessed 24 June 2022.

[1505] CPR PD 63AA – Financial List <www.justice.gov.uk/courts/procedure-rules/civil/rules/financial-list/practice-direction-63aa-financial-list> accessed 24 June 2022.

filed in the Financial List,[1506] that pose problems of general relevance for which competent authoritative English law guidance is required right away. The claim is called a 'qualifying claim'.[1507] The scheme's goal is to make it easier to resolve market disputes on which no English authoritative precedent exists and to avoid expensive and time-consuming litigation by furnishing a method for authoritative guidance before a disagreement arises.[1508] In these situations, the scheme allows the qualifying claim to be decided without the necessity for a dispute to have developed between the parties.[1509] The scheme furnishes a procedure for the court to award declaratory relief in a 'friendly action' as it is in the public interest to so do, as per the recommendations offered in *Rolls-Royce v Unite the Union*.[1510] These claims will necessitate the existence of facts upon which the judgment will be based. The facts should preferably be accepted by the parties. Moreover, the court must be convinced that all points of view are presented completely and correctly.[1511]

Therefore, in the proposal made, the FCA could use the Financial Market Test Case Scheme to file a test case in court to seek compensation for many customers after consulting with the relevant banks and customers. The FCA could choose a representative sample of customer complaints and submit the most compelling arguments in the public interest.[1512] The FCA test case would affect many customers. There would be no need for customers to initiate proceedings individually after the FCA decided to institute the test case. Thus, the FCA test case would offer a relatively quick and low-cost solution to legal ambiguity. Instead of addressing all concerns, the test case would focus on a few key ones. It would not determine the compensation for

[1506] According to CPR 63A, the Financial List is a distinct list, in the High Court, which came into effect on 1 October 2015. It handles complicated financial markets claims that are for a substantial value (more than GBP 50 million), necessitate particular financial markets expertise, and/or elicit market concerns of significant relevance. Its objective is to furnish a platform for faster, more efficient and less expensive financial dispute resolution. Parties may initiate Financial List proceedings in either the Commercial Court or Chancery Division. The case will be managed by a specialised judge from beginning to end, even through enforcement, if need be.
[1507] CPR PD 63AA, s 6.1.
[1508] HM Courts and Tribunals Service, 'Financial List: History' <www.judiciary.uk/you-and-the-judiciary/going-to-court/high-court/courts-of-the-chancery-division/financial-list/history/> accessed 24 June 2022.
[1509] CPR PD 63AA, s 6.2.
[1510] *Rolls-Royce plc v Unite the Union* [2009] EWCA Civ 387.
[1511] HM Courts and Tribunals Service, 'Guide to the Financial List' (1 October 2015) s 9.2 <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/644030/financial-list-guide.pdf> accessed 24 June 2022.
[1512] See *The Financial Conduct Authority v Arch Insurance (UK) Ltd* [2021] UKSC 1.

every customer, but it would lay down the groundwork for it. If the case is successful, one benefit would be that banks would thereafter opt to compensate customers on their own initiative and the FCA would request banks to act on claims similar to those which the court resolved. The test case decision would end legal conflicts and, consequent to it, a substantial number of comparable cases would subsequently succeed.[1513]

Following the judgment, the FCA would communicate with banks to ensure that complaints are resolved, and the pertinent compensation is paid. The FCA would coordinate with banks and the court so that the latter would be able to grant the relevant declarations. The FCA would also advise banks to contact customers, that could have been affected by the judgment, to consider their options.[1514] Additionally, the FCA would advise affected customers to contact their banks. Customers that would remain dissatisfied could apply to the FOS or find alternative ways to fund litigation.

7.4.3 Class Actions in UK

Another possibility of encouraging customers to institute legal proceedings is through class actions. Class actions in the UK are different from those in the US. Class actions are claims brought by various claimants based on alleged misconduct by the same or different defendants that inflicted loss to the claimants in a similar or identical way. Individual claims are frequently insufficiently substantial to be economically viable but pursuing claims collectively allows for economies of scale. However, there are hazards and obstacles for both claimants and defendants to overcome.[1515]

[1513] See FCA, 'Press Release: 'Supreme Court judgment in FCA's business interruption insurance test case' <www.fca.org.uk/news/press-releases/supreme-court-judgment-business-interruption-insurance-test-case> accessed 24 June 2022.
[1514] ibid.
[1515] Linklaters, 'Collective redress across the globe – UK' (1 January 2022) <www.linklaters.com/en/insights/publications/collective-redress/collective-redress-across-the-globe/uk> accessed 24 June 2022.

There are three main processes whereby claimants may file class actions: group litigation orders, representative actions and collective actions in private actions (opt-out private actions) for breaches of competition law. Two methods are governed by Part 19 of the Civil Procedure Rules ("CPR") whereas the third is provided for by section 47B of the Competition Act 1998 as updated by paragraph 5 of schedule 8 of the Consumer Rights Act 2015. Most options work on an 'opt-in' basis, which means that each claimant must take proactive steps to participate. On the other hand, an 'opt-out' approach permits a party to file an action for and on behalf of a whole class without the explicit permission or even awareness of every class member.[1516]

7.4.3.1 Group Litigation Orders

A group litigation order (GLO) is an order, issued by a court, which allows for the case management of claims that raise similar factual or legal issues (GLO issues).[1517] A claimant may apply to the court for a GLO as per CPR Part 23 anytime prior to or after any pertinent claims have been served.[1518] The application will include the prevalent GLO issues likely to emerge in court.[1519] Every claimant is responsible for filing their own lawsuit. Yet, when there are or are expected to be various claims raising the GLO concerns, the court may issue a GLO to enable the case management of such claims.[1520] When a GLO is granted, a group register must be formed wherein information of all claims filed by individual claimants and to be managed under the order must be inserted.[1521] Unless the court instructs differently, a judgment or order delivered in a claim on the group register regarding one or more GLO issues is binding on the parties to all other claims on the group register at the time the judgment or order is delivered, and the court may direct as to the degree to which that judgment or order is binding on the parties to any claim that is thereafter included in the group register.[1522] Each claimant will only be responsible for their share of the costs. However, under the cost assessment procedure, it is common for the successful party to recover all or

[1516] CPR, Part 19, section II and section III; Competition Act 1998, s 47B.
[1517] CPR, r 19.10.
[1518] PD 19B, s 3.1.
[1519] PD 19B, s 3.2(4).
[1520] CPR, r 19.11(1).
[1521] CPR, r 19.11(2).
[1522] CPR, r 19.12(1).

part of the expenses from the losing party on conclusion of the proceedings.[1523] Alternatively, the claimant may enter into a CFA or DBA with a lawyer as discussed earlier.

7.4.3.2 Representative actions

Representative actions may be brought by or against a party as representative of one or more individuals having an identical interest in a claim. Thus, when more than one person has the same interest in a claim, the latter may be initiated or the court may order that the claim be proceeded by one or more of those individuals as representatives of any other persons having that interest.[1524] The same interest must be a common interest, based upon a shared grievance, and the primary remedy sought must be advantageous to all. Common factual or legal issues, such as a duty's existence and its breach, are insufficient. The court may also issue an order assigning an individual to represent a class of individuals having the same interest in a claim where one or more class members cannot be traced or clearly identified, or appointing a representative would advance the underlying goal.[1525] Any judgment or order delivered in a representative action is binding on all individuals represented in the claim unless the court decides differently. However, it may only be enforced by or against an individual not being a party to the claim with the court's approval.[1526] Representative actions have been hard to bring due to the same interest requirement. Moreover, it has traditionally been read severely by the courts, resulting in a restricted uptake of representative claims. Representative actions are basically 'opt-out'.[1527]

[1523] CPR, r 46, PD 19B, ss 16.1, 16.2.
[1524] CPR, r 19.6(1).
[1525] CPR, r 19.7(2)(d).
[1526] CPR, r 19.6(4).
[1527] CPR, Part 19, section II, r 19.6.

7.4.3.3 Derivative claims

There is another type of representative action, namely, a derivative action, or derivative claim.[1528] A derivative claim allows a company's shareholder to seek remedy from the company's directors and/or officers and/or any involved third parties for wrongdoings committed against the company. The claim is 'derivative' because the company has the right of action and shareholders can institute the claim in their own name on the company's behalf. Such claims can be instituted either through the statutory framework set out Part 11 of the Companies Act 2006 or through the common law. A claim form must be completed to commence a derivative claim. The company must be named as defendant in the lawsuit. Both types of claims must obtain approval from the court to be able to proceed.[1529]

It is argued that derivative claims are of little use to bank customers. A statutory derivative claim may solely be instituted by a company's member[1530] for a cause of action bestowed in that company and is pursuing remedy on behalf of such company. Furthermore, a derivative claim may solely be made in connection with a cause of action emanating from an actual or proposed act or omission comprising negligence, default, breach of duty or breach of trust by a company's director, or pursuant to a court's order in section 994 proceedings for members' protection against unfair prejudice. The action may be brought against the director or some other individual or both. It is irrelevant whether the cause of action originated prior to or after the individual who wants to institute or continue the derivative claim became a member.[1531]

Notably, the statute has replaced the common law derivative claim but does not apply to multiple derivative claims due to the way it is drafted. Thus, notwithstanding that

[1528] CPR, rr 19.9– 9.9F; Companies Act 2006, ss 260-264 for derivative claims in England and Wales or Northern Ireland and ss 265-269 for derivative proceedings in Scotland; see David Milman, 'UK Shareholder Litigation: Latest Cases Reviewed' (2021) 425 Sweet and Maxwell's Company Law Newsletter 1, for derivative claims in UK.
[1529] CPR, r 19.9(4); Companies Act 2006, ss 261, 263.
[1530] Companies Act 2006, s 260(5) states that a company's member includes a non-member to whom company shares have been transferred or transmitted by operation of law.
[1531] Companies Act 2006, s 260.

the common law concepts have been abolished by what is commonly regarded a broader statutory framework, since only members may avail of the latter, the common law nevertheless governs multiple derivative claims.[1532] Such claims may arise when a member of a parent company seeks to advance a cause of action bestowed in a subsidiary of the parent company or subsidiaries of the subsidiary. The restricted common law derivative claim evolved as a limited, 'fraud on the minority' exception to the majority control rule established in *Foss v Harbottle*.[1533] The common law claim requires the essential elements of fraud as well as wrongdoer control to subsist.[1534]

7.4.4 Class actions in Israel

A similar, but not identical, approach has been taken in Israel in relation to class actions and derivative actions. It is relevant to consider such approach because it affords a high degree of protection. Under the Securities Law,[1535] the Israeli Securities Authority (ISA) has regulatory, supervisory and enforcement powers, including the ability to intervene in private enforcement proceedings**,** such as funding class actions and derivative actions, when the ISA believes a genuine public interest exists and the court is likely to authorise the lawsuit.[1536] In fact, in Israel, private enforcement of securities law is primarily accomplished through class actions and derivative actions.[1537] A class action is an action initiated by a representative claimant on behalf of a class of individuals who have not authorised the representative to sue. The action draws on factual and legal issues pertinent to all such individuals.[1538] A class action

[1532] *Universal Project Management Services Ltd v Fort Gilkicker Ltd* [2013] 3 WLR 164.
[1533] *Foss v Harbottle* 67 E.R. 189 (1843) 2 Hare 461; see also *Iesini v Westrip Holdings Ltd* [2010] BCC 420 [73]–[75].
[1534] *Prudential Assurance Co Ltd v Newman Industries Ltd (No 2)* [1982] Ch 204.
[1535] Securities Law (5728–1968).
[1536] See the Securities Law, s 55C in relation to class actions; the Companies Law (5759-1999), s 205A in relation to derivative actions.
[1537] Michael Ginsburg and Hadar Shkolnik, 'The Securities Litigation Review: Israel' (7 June 2021) <https://thelawreviews.co.uk/title/the-securities-litigation-review/israel> accessed 24 June 2022; Legal Briefing, 'Class actions in Israel – a cautionary tale for international corporations' <www.inhouselawyer.co.uk/legal-briefing/class-actions-in-israel-a-cautionary-tale-for-international-corporations/>(2019) accessed 24 June 2022.
[1538] Class Actions Law (5766-2006), section 2; in Israel, the Class Actions Law is the primary source of law concerning class actions. It establishes rules for instituting such actions; it regulates both substantive and procedural elements of class actions. The Class Actions Regulations, 5770-2010, specify certain procedural features of how class actions must be performed in court in greater detail.

is commonly invoked when a company, consequent to a contractual or legal breach, inflicts comparatively minor harm to a member of a significant class of individuals but damage to the class as a whole is enormous.[1539] A derivative action is brought on behalf of a company by a director or shareholder under the Israeli Companies Law, when the company abstains from exercising its right to file a lawsuit.[1540] Claims and approval applications are essentially filed in the civil courts.

Interestingly, the Israeli legislature has created a public fund to finance class actions. It aids representative claimants in filing applications, which carry social or public value, for court approval.[1541] The fund is operated by a board of nine members nominated by the Minister of Justice. The board comprises representatives from pertinent government agencies, including the Attorney General, Supervisor of Banks, Consumer Protection Commissioner and Competition General Director. Specific requirements, for instance, the issue's particular circumstances, the class action's social and public relevance class and its contribution to the ideals it seeks to safeguard, as well as additional factors the board may examine, must be met to support the class action.[1542]

Only applications relating to claims specified in the Class Actions Law's Schedule 2[1543] or to issues expressly designated for such objective under an explicit provision of law can be filed for approval. The Class Actions Law's Schedule 2 permits claims in several fields, including consumer redress in financial services. These include claims against banks arising out of their relationships with customers, whether the latter effected a transaction or not.[1544] Typically, situations involve a single consumer that may not have a compelling reason to seek compensation for little personal harm and bringing an independent claim would be unfeasible. Yet, the total amount of damages

[1539] Gal Rozent, Hagai Ashlagi and Ran Karmi, 'Class/collective actions in Israel: overview' <https://uk.practicallaw.thomsonreuters.com/8-617-6659?transitionType=Default&contextData=(sc.Default)> accessed 24 June 2022.
[1540] Companies Law, ss 194-206.
[1541] See Class Actions Regulations (Aid in Funding Applications for Approval and Class Actions), 5770-2010, and Class Actions Regulations (Work Procedures of the Fund for Funding Class Actions), 5770-2010, which address the fund's operational processes.
[1542] Class Actions Regulations (Aid in Funding Applications for Approval and Class Actions), 5770-2010.
[1543] Class Actions Law, s 3(a).
[1544] Rozent, Ashlagi and Karmi (n 1539).

induces a representative to submit a class action claim. The class action process permits all class members to be compensated without them having to take any direct measures. The representative claimant will attain a higher compensation given their efforts.

Essentially, the process involves the claimant presenting their own claim, which has to be predicated on the claimant's own individual cause of action, along with an application to have the personal claim approved as a class action by a judge. The claimant asks for permission to intervene on behalf of the whole class as a representative claimant. The claim can solely progress as a class action if the court approves it.[1545] The court usually takes a decision on the class action application first because the personal claim is ordinarily withdrawn if the class action is refused.[1546] A similar derivative action procedure is also available.[1547]

The court will approve the class action if all the following requirements are satisfied: the action involves substantial factual or legal issues relevant to all class members and it is reasonably likely that they will be decided in their favour; given the circumstances, a class action is the most effective and fair option to resolve the disagreement; and reasonable grounds exist for believing that the class members' interests will be properly represented and handled in good faith.[1548] However, in specific circumstances stated in the Class Actions Law, the court may diverge from such criteria.

Thus, Israel's approach is preferable to that of the UK approach because, essentially, Israel's regulatory authority is empowered by legislation to fund class actions, the legislator has created a public fund to finance such class actions and a clear procedure with a specific set of criteria is in place for approval or otherwise of such funding.

[1545] Class Actions Law, s3(b).
[1546] Rozent, Ashlagi and Karmi (n 1539).
[1547] Companies Law, s 198; Ginsburg and Shkolnik (n 1537).
[1548] Class Actions Law, s8(a).

7.4.5 Third-party funding

Another option for supporting consumer litigation costs is third-party funding (TPF). TPF is increasingly achieving popularity as a means of funding lawsuits in the UK. Such funding may be especially useful in collective actions and many would be impossible to carry out without it. The so-called *Arkin* cap[1549] which restricts a potential funder's liability for adverse expenses to the sum financed, may limit fees' recovery by third-party funders, albeit it is not always applicable and surely not compulsory.[1550] A third-party funder normally covers all the expenses associated with pursuing and enforcing a claim. If the claim is successful, the funder is reimbursed for its expenses and a return on its investment. The increase could be between 60% and 500%. If the claim is unsuccessful, the claimant is not responsible for any of the expenses associated with the claim.[1551]

7.4.6 Proposed model of funding

Having reviewed the options available, it is argued that the option better suited to the proposal being made is the Israeli approach because it is the most protective and effective for customers. It offers the best chance of persuading a public body to finance litigation. Some adaptations are, however, recommended. The statute would first affirm some form of presumption in the event of a claim for breach of the fiduciary duty.

Furthermore, the statute which is being proposed would state that private litigation by aggrieved customers would be funded by public funding. Similar to what happens in Israel where the ISA is empowered to intervene in financing class actions, under the proposed statute, the FCA would be specifically empowered to provide such funding by managing a public fund financed from its income. In this regard, it is worth noting

[1549] *Arkin v Borchard Lines Ltd and others* [2005] EWCA Civ 655.
[1550] See Code of Conduct for Litigation Funders (the ALF Code).
[1551] Pinsent Masons LLP, 'Third party funding: an introduction' (8 September 2020) <www.pinsentmasons.com/out-law/guides/third-party-funding-introduction> accessed 24 June 2022.

that making funding available to customers has already been insinuated by the FCA in relation to costs attributable to the filing of debt relief orders.[1552] The statute would provide a mechanism for the approval of funding. The proposed mechanism would ascertain that the customer would have a reasonable prospect to succeed. The statute would state that the aggrieved customer who would want to bring litigation would be able to file an application to request the FCA to provide indemnity for the litigation costs and the FCA would subsequently decide such application. Customers would be able to apply either in their own name for an individual cause of action or as a representative to bring a class action in court. The customer would specify this in the application and would provide details of the complaint or complaints. The decision for approval for funding would be taken within a reasonable period of time, which would not exceed six months.

Similar to Israel, the decision would be made by a committee. However, such committee would be composed slightly differently. The proposed committee would comprise regulatory personnel, essentially, the directors of the FCA's Authorisation, Supervision and Enforcement Units, and former judges, possibly two judges, to introduce independent members given that the committee would have a quasi-judicial role. Essentially, the committee would decide what it would deem to be meritorious claims/cases. The committee would take the decision on whether to provide funding or not using a given set of criteria. The statute would not contain vague criteria, such as 'of general relevance', because this would be developed by common law. Moreover, legal certainty is desired. Customers should be able to sue without having to show that the issue is of general importance, whenever they have been robbed, whenever banks have acted wrongly. The FCA already has a certain jurisdiction under the Financial Markets Test Case Scheme, but the proposed statute would provide that it would have a broader jurisdiction than that currently available in such scheme for the statutory fiduciary duty to work.

[1552] FCA, 'The Woolward Review – A review of change and innovation in the unsecured credit market' (2 February 2021) <www.fca.org.uk/publication/corporate/woolard-review-report.pdf> accessed 24 June 2022.

The criteria would be such that they would enable as many customers as possible with meritorious claims to institute legal proceedings. These criteria should promote access to justice rather than hinder it for customers. Therefore, these criteria would be basic criteria, namely, consideration of the facts of the customer's case to examine whether the case is genuine and whether it has a decent likelihood of success. These criteria would obviously apply both to an individual case or a class action. In the case of a class action, additional criteria would apply precisely because it is a class action. These other criteria would merely be consideration of whether the case would raise significant common questions for all class members; whether the interests of all class members would be represented and managed fairly and adequately; and whether a class action would be the best option. These criteria would thus set a threshold below which the FCA would never fund a claim because it would be a waste of public money.

It is acknowledged that in an ideal world, what would be hoped to achieve is that any case that satisfies these minimal fundamental criteria and, hence, passes the aforementioned threshold would be funded by the FCA to give full protection to as many customers as possible. It would be desired that the banks' levy would be satisfactory for the FCA to have enough funds to finance every customer's case which passes the threshold and to have sufficient and competent staff to be able to pursue all meritorious cases. However, in the real world, in practice, this may be hard to achieve due to politics and policy making, banks resisting the levy and claiming it to be very high, and limitation of regulatory personnel. It is therefore further recognised that there is a need for another set of criteria to prioritise among cases that meet the minimum criteria. These criteria would consist of consideration of the number of customers bringing the same complaint or whether, although one or a few customers would be bringing the complaint, it would be socially or publicly important in the sense that if the case would succeed, many customers would subsequently be able to obtain compensation from the relevant banks.

It is argued that it is sensible to include a private right of action for customers rather than leaving it to the FOS precisely because the problem with the FOS is that it has no binding precedent. The FOS decisions are not binding on the FOS. There is no

principle that the FOS is bound by its own precedent. Having recourse to litigation means the courts could develop precedent and court decisions would create more certainty. Court decisions would create principles and more clarity that does not exist now. This gives more justice, more transparency because another problem of the FOS is that it is not a transparent system. It does not operate as a court, it can give more compensation in one case, less in another.

As a result of the proposal made, it is suggested that customers would not be restricted in instituting litigation proceedings. If a customer claims a breach of the statutory fiduciary duty, the customer should be able to sue the bank in court. The court would determine whether the bank was in breach or not. Legislation is binding on the court. A recourse is wanted for customers who have suffered harm. There is no point of law. It is very clear what the law is. It is just that the bank has mistreated them. All they need is to be able somehow to find justice. It is an access to justice point. Hence, a much lower threshold is desired than the current threshold to make the fiduciary duty work to provide adequate protection to customers.

It may be argued that by giving such a broad private right of action, there would be too much litigation. In response, it is argued that without finance, there would be no litigation at all. This risk of excessive litigation would be mitigated if the FCA would take a sensible approach in filtering applications to finance private actions. However, simultaneously, it is argued that the FCA should be willing to assist a substantial number of customers to institute proceedings against banks. Such approach would inevitably lead to an increase in litigation, but the solution would be for more judges to be appointed to deal with the volume of cases. It may be argued that a lot of public money would be spent. However, it is argued that the FCA should impose a levy on the industry to finance its public fund. Granted, there would be a risk that the industry would roll over the levy on the customers. In response, it is argued that competition law should ensure that there is more effective competition in banking.[1553] This would

[1553] See Maria Ioannidou, 'Responsive' Remodelling of Competition Law Enforcement' (2020) 40 (4) Oxford Journal of Legal Studies 846; Viktoria H S E Robertson, 'The relevant market in competition law: a legal concept' (2019) 7(2) Journal of Antitrust Enforcement 158.

reduce banks' ability to roll over the levy on customers and the banks would absorb more of it through and so more of the cost would eventually be borne by bank shareholders and senior management who would receive less performance-based remuneration if banks were less profitable. It is acknowledged that the levy is another redistributive mechanism.

Thus, it is recalled that in Chapter Two, it is argued that redistribution can be used in two narrow, defined contexts, namely in the context of financial exclusion and in the context of ensuring that the cost of banking regulation and supervision is paid by banks themselves. Hence, as discussed in Chapter Two, it is hereby claimed there are two types of redistributive mechanisms which are accepted in the proposal made. One is from banks to customers in the context of ensuring that they provide a service to everybody including those at risk of financial exclusion because they resemble public utilities. The other is from banks to taxpayers to the extent that banks themselves need to cover the costs of their regulation and supervision as well as to pay a levy for the FCA's fund, that is, to finance litigation against themselves.

7.5 Conclusion

This chapter argues that the imposition of a statutory general fiduciary duty on banks to customers would provide a suitable approach for a synthesis of private law and financial regulation to form a coherent system of finance law which would furnish adequate protection to bank customers. Such a statutory duty would provide the kind of legal paternalistic intervention, the kind of impure paternalism, required to address customers' needs. It would furnish both *ex ante* and *ex post* protection, thereby catering for welfare throughout the lifecycle of the bank-customer relationship, taking into account life-changing events that customers may experience. The chapter also argues that such statutory duty should be actionable both by private enforcement, that is, by a private right of action available to customers, and by regulatory enforcement, that is, the FCA would be able to impose sanctions, fines and penalties for breach of the duty. The chapter further contends that the private right of action should be

underpinned by public funding by the FCA. It provides a realistic proposal, based on the Israeli approach, whereby it would be possible for the FCA to fund litigation costs for either single customers or class actions. Importantly, it is suggested that, for the proposal made to work without imposing high costs to bank customers as a whole, a very effective competition regime should be in place. The design of such an effective system of competition regulation for the banking sector lies outside the scope of the present thesis.

At the same time, it is acknowledged that there are limits to banks' positive duty to advise their customers. Banks may lack qualified staff to provide comprehensive financial advice and, in any case, such advice may be better provided by independent and qualified debt or investment advisors who, unlike banking staff, are not affected by conflicts of interest and agency problems. The argument herein does not undermine the value of independent financial advice nor the case for future work on the regulation of the financial advice industry that would render it more friendly to consumers and accessible. However, it is contended that the proposed bank duty to advise would fill a major gap and that it can work symbiotically with the independent advice industry. Moreover, the intrusion into customers' private affairs associated with unsolicited counselling provided by banks might be seen as going too far in some situations, especially when customers seek loans to cover expenses of a highly personal and confidential nature. Given English courts' general ethos, however, it is likely that the proposed statutory duty would be construed and applied in a way that respects the autonomy of bank customers while also affording robust protection of their financial interests.

Chapter Eight

Conclusions

The thesis has identified, first of all, that bank customers need legal protection to be impurely paternalistic. This is due to their behavioural biases, weaker position and vulnerability, banking services' necessity, financial exclusion risk and banks' misconduct. The thesis has also acknowledged that while the basic argument is that legal protection must be impurely paternalistic, a restricted degree of wealth redistribution is accepted in specific contexts, namely, to avoid financial exclusion of customers, given banking services' resemblance to public utilities, and to impose the costs of banks' regulation and supervision on banks themselves. The thesis has concluded that the existing legal and regulatory framework fails to adequately provide such paternalistic protection.

The thesis has argued that the common law of contract fails to provide adequate protection because it advocates significantly freedom of contract with the exception of the doctrine of undue influence and penalty rule, which interfere with freedom of contract, and fails to furnish the kind of impure paternalism required. Furthermore, it practically furnishes limited *ex ante* protection, at the time the contract is concluded. Common law commences from the proposition that the bank-customer relationship is an arm's length relationship wherein both parties are able to protect themselves and banks do not owe a general fiduciary duty to customers. The bank-customer relationship is basically a commercial, contractual and debtor-creditor one; the law respects autonomy and freedom of contract and insertion of exclusion of liability and variation clauses in contracts are allowed; banks do not owe a general duty of reasonable skill and care to customers; banks have no duty to advise unless this is specifically agreed with the customers; and banks can contract out of their implied duty of confidentiality or are allowed to disclose information provided prior consent from customers is obtained.

The thesis has further claimed that the two key common law rules, specifically, the doctrine of undue influence and the penalty rule are flawed. The doctrine of undue influence has a narrow scope as it covers bank customers who provide surety or guarantee and is merely a formal process to ensure that banks obtain a certificate confirming that such customers have received independent legal advice. In relation to the penalty rule, the UK Supreme Court has effectively tightened the test thereby making it harder for the customers to escape from the contract's clause. Moreover, a penalty clause can be so craftily drafted that it can be masked as a valid and enforceable default clause or agreed damages clause. Additionally, a drive has been initiated to abolish the penalty rule altogether.

Furthermore, the thesis has demonstrated that the two main consumer protection statutes, namely, the CRA 2015 and CCA 1974, fail to provide adequate protection to bank customers because, although they favour freedom of contract less than the common law of contract given the requirements they impose on banks, they nevertheless also fail to provide the impure paternalism desired. Moreover, together, they primarily furnish a restricted degree of *ex ante* and *ex post* protection. Some provisions of these statutes, particularly the CRA 2015's unfair terms provisions and the CCA 1974's unfair relationships provisions, are lengthy, difficult to comprehend and unpredictable. Further, whilst the CRA 2015's assessment criteria are comprehensive as they consider the contract's nature and circumstances, and are broad in scope because they apply to all types of consumer contracts, they merely evaluate whether the imposed individual terms were unfair. Moreover, the relevant CRA 2015 provisions do not apply to the fairness of the contract's main terms or the price's appropriateness if these are transparent and prominent. Contrastingly, the CCA 1974's unfair relationships sections empower a court to consider individual terms and how the bank has exercised or enforced any right under the agreement or any associated agreement, or any other thing carried out, or not carried out. Additionally, the relevant CCA 1974 requirements apply to the contract's essential terms. However, they have a narrow scope as they are solely applicable to credit agreements.

Moreover, the thesis has also concluded that tort law does not furnish adequate protection because it acclaims freedom of contract more than the common law of contract since there are no interferences with freedom of contract and, hence, does not furnish the type of impure paternalism required. Furthermore, tort law only provides *ex post* protection. The thesis has illustrated that there are various difficulties in the tort of deceit, the tort of negligence generally, the tort of negligent misstatements, the relationship between tort and contract, and the MA 1967. A fraud claim requires thorough evidence, which is hard to attain, and is discovered after it is too late to do anything as the transaction will have been concluded. Banks do not owe a general tortious duty to exercise reasonable care and skill to prevent pure economic loss to customers and do not owe a tortious general advisory duty either. Moreover, the MA 1967 also provides inadequate protection because it fails to provide the necessary impure paternalism. Furthermore, the MA 1967 furnishes no *ex ante* protection and a narrow degree of *ex post* protection due to its clumsy drafting, especially in holding that banks making an innocent misrepresentation which induces customers to enter into a contract consequent to which the latter suffer loss are liable as if the misrepresentation was carried out fraudulently. Although courts may provide a degree of *ex post* protection, they are hesitant to hold banks liable under a contractual duty of care or for a tortious duty of care or for having furnished no advice or rendered negligent advice to customers.

Additionally, the thesis has concluded that the FCA's legal and regulatory regime also provides inadequate protection because, notwithstanding that it endorses freedom of contract even less than statutory consumer law, it still fails to provide the kind of impure paternalism needed. It also essentially furnishes limited *ex ante* protection and practically no *ex post* protection. This is clear from deficiencies present in the FCA's Handbook, powers, consumer redress, approach to protecting consumers and the new Consumer Duty. The chapter has further claimed that the *ex ante* protection afforded by the FCA's regulatory regime is further limited given its inherent incoherence, the possibility of regulatory arbitrage and the advice gap present at the point-of-sale stage, consequent to which customers may not adequately engage in banking services and may not take optimal financial decisions.

Moreover, the thesis has argued that *ex post* protection may be provided by the FCA's enforcement and collective redress powers; bank customers' private right of action pursuant to section 138D of FSMA 2000 for breaches of relevant regulatory rules but not the Principles, including the new Consumer Duty; and the out-of-court dispute resolution mechanism furnished by the FOS. The thesis has, however, remarked that such *ex post* protection is drastically curtailed through the FCA's restricted resources and the FOS's lack of precedent and its award limit being capped at GBP 355,000. Furthermore, the thesis has also argued that the FOS provides limited protection in the sense that while bank customers may seek *ex post* redress, it is queried whether this is actually provided when no point-of-sale problems are present. Importantly, the thesis has pointed out that a significant limitation on the effectiveness of *ex post* protection is the fact that English courts refuse to recognise that the regulatory regime imposes private law duties on banks and that they cannot be limited or excluded by exclusion or limitation of liability clauses.

Additionally, the thesis has argued that two consumer protection gaps also reduce *ex post* protection for bank customers. One such gap relates to post-sale care whereby, since the regulatory regime does not impose any obligations on banks beyond the point-of-sale stage, banks are not required to assist customers post sale and conduct periodic reviews for them. The other gap concerns financial welfare outcomes whereby, since the FCA does not monitor banking products and services' outcomes and consequences, bank customers are unassisted in any welfare difficulties they face beyond point of purchase.

Importantly, the thesis has ascertained the kind of reform necessary to provide adequate protection to bank customers. The thesis has concluded that a synthesis of private law and financial regulation is required to form a coherent system of finance law for adequate bank customer protection. The thesis has proposed and contended that this is possible through primary legislation which would provide a statutory general fiduciary duty to customers. The thesis has provided the type of fiduciary duty required to render the necessary protection which the existing law cannot afford. First, the proposed fiduciary duty would be interpreted as the common law and equity principles

on which it is based and the new statute would affirm so. The duty would be a general fiduciary duty imposed on banks. It would comprise the duty to be loyal; act in the customer's best interests; act in good faith and not abuse their trust; avoid conflicts of interest; not act for the bank's or a third party's advantage without the customer's informed consent; and maintain the confidentiality of the customers' affairs.

The thesis has also claimed that, in parallel to these fiduciary duties, the statute would codify the imposition of a duty to act with reasonable care and skill on banks in line with the FCA's regulatory rules. Thus, the duty of care would complement the fiduciary duty and both could apply to the same context, for instance, the operation of savings and similar accounts, lending services and investment services. The proposed fiduciary duty would provide ethical conduct, ethics having also been advocated for in the thesis. The duty would allow banks to be reasonably remunerated for their services. However, it would prevent banks from profiting from the performance of obligations without the customer's informed consent. The proposed statute would affirm the duty to be mandatory and only permit the duty to be waived if the customer is a high net worth individual or very sophisticated. Importantly, the thesis has asserted that the fiduciary duty would incorporate the duty to advise and this would be a mandatory duty, which would be required to be exercised with reasonable care and skill. This enhances legal certainty. The duty to advise would be a manifestation of the fiduciary duty and would be applicable to all important contracts with customers, particularly in the context of lending and investment. The thesis has argued that the fiduciary duty and duty of care would be heightened as the proposed statute would assert a presumption of negligence and, therefore, a reversal of the burden of proof in the customer's favour.

The thesis has argued that the new statute would provide for double enforcement of the fiduciary duty, that is, through private enforcement and regulatory enforcement. One way of private enforcement is through the institution of proceedings in the courts by customers. The statute would furnish a private right of action to customers. The statute would also empower the FCA to be able to intervene in such litigation to

support the customer if it so wishes. Moreover, the statute would also provide for the possibility of the FCA to bring class actions on behalf of customers.

The thesis has argued that such a general statutory fiduciary duty would provide adequate protection because it would furnish both *ex ante* and *ex post* protection, including in the contexts of consumer credit, investment and savings accounts. Therefore, it would protect the welfare of customers throughout the whole duration of their relationship with banks, which relationship may experience life-changing situations. The thesis has also proposed an alternative to legislation, namely, for the FCA to introduce this kind of fiduciary duty and make it actionable through section 138D of FSMA. The thesis, has, however, contended that this is not as satisfactory as legislation, which would increase publicity, legitimacy and be more realistic.

The thesis has acknowledged that simply introducing any duty in legislation would provide in itself very limited protection to bank customers because it is highly probable that they lack financial resources. The thesis has therefore recommended a realistic and plausible method, based on Israel's approach, of implementing the statutory fiduciary duty, namely by public funding by the FCA. In this manner, the thesis has thus provided a means to have private enforcement of the fiduciary duty on top of regulatory enforcement. The thesis has held that the statute that would enact the fiduciary duty would empower the FCA to provide funding by managing a public fund financed from its income. The statute would allow the FCA to finance litigation costs both to customers who intend to institute proceedings individually and to those who intend represent others in class actions.

The thesis has proposed a mechanism whereby the customer would have a reasonable chance of being successful in obtaining the required funds. The aggrieved customer who wants to institute litigation proceedings would request the FCA to provide indemnity for the litigation costs by filing a petition and the FCA would subsequently decide thereupon. Customers would be able to apply either in their own name for an individual cause of action or as a representative to bring a class action in court. The customer would specify this in the petition and would provide details of the

complaint or complaints. The decision for approval for funding would be taken within a reasonable time, not exceeding six months.

The thesis has argued that the decision would be taken by a committee composed of regulatory personnel, essentially, the directors of the FCA's Authorisation, Supervision and Enforcement Units, and former judges, possibly two judges, to introduce independent members given that the committee would have a quasi-judicial role. Essentially, the committee would decide what it would deem to be meritorious cases. The committee would take the decision on whether to provide funding or not using a given set of criteria. The statute would not contain vague criteria, such as 'of general relevance', because this would be developed by common law. Moreover, legal certainty is desired. Customers should be able to sue without having to show that the issue is of general importance, whenever they have been robbed, whenever banks have acted wrongly. The FCA already has a certain jurisdiction under the Financial Markets Test Case Scheme, but the proposed statute would provide that it would have a broader jurisdiction than that currently available in such scheme for the statutory fiduciary duty to work.

The criteria would be such that they would enable as many customers with meritorious as possible claims to institute legal proceedings. These criteria should promote access to justice rather than hinder it for customers. Therefore, these criteria would be basic criteria, namely, consideration of the facts of the customer's case to examine whether the case is genuine and whether it has a decent likelihood of success. These criteria would obviously apply both to an individual case or a class action. In the case of a class action, additional criteria would apply precisely because it is a class action. These other criteria would merely be consideration of whether the case would raise significant common questions for all class members; whether the interests of all class members would be represented and managed fairly and adequately; and whether a class action would be the best option. These criteria would thus set a threshold below which the FCA would never fund a claim because it would be a waste of public money.

The thesis has argued that in reality, it is likely that the FCA would not have sufficient funds to finance every customer's case which passes the threshold and would have lack of competent human resources to be able to pursue all meritorious cases. Moreover, funds would be less than desired/anticipated due to politics and policy making, banks resisting the levy and claiming it to be very high. The thesis has therefore provided that the statute would include another set of criteria to prioritise among claims/cases that meet the minimum criteria. These criteria would consist of consideration of the number of customers bringing the same complaint or whether, although one or a few customers would be bringing the complaint, it would be socially or publicly important in the sense that if the case/claim would succeed, many customers would subsequently be able to obtain compensation from the relevant banks.

The thesis has further concluded that it is sensible to include a private right of action for customers rather than leaving it to the FOS precisely because the problem with the FOS is that it has no binding precedent and is not a transparent system. Customers having recourse to litigation means that the courts could develop precedent and court decisions would create more certainty.

The thesis has claimed that the FCA should impose a levy on the industry to finance its public fund. This would reduce banks' ability to roll over the levy on customers and the banks would absorb more of it through and so more of the cost would eventually be borne by bank shareholders and senior management who would receive less performance-based remuneration if banks were less profitable. The thesis has acknowledged that the levy is another redistributive mechanism. Hence, ultimately, the thesis has recognised that redistribution can be used in two narrow, defined contexts, namely in the context of financial exclusion and in the context of ensuring that the cost of banking regulation and supervision is paid by banks themselves. Hence, the thesis has claimed there are two types of redistributive mechanisms which are accepted in the proposal made. One is from banks to customers in the context of ensuring that they provide a service to everybody to avoid the risk of financial exclusion because banking services resemble public utilities. The other is from banks

to taxpayers to the extent that banks themselves need to cover the costs of their regulation and supervision as well as to pay a levy for the FCA's fund, that is, to finance litigation against themselves.

The thesis has dealt with banks and natural persons as bank customers. It has excluded legal persons from the analysis. Further, it has considered consumer protection from the private law and public law perspectives. It has not taken into account competition law. Additionally, it has not considered property law and criminal law, both of which also contribute to consumer protection. Consequently, the thesis suggests future research, possibly, on bank customers that are legal persons. It further recommends future research on consumer protection to be undertaken, essentially, from competition law perspective but also from property law and criminal law end. It also recommends future research on possible limitations of banks' positive duty to advise customers, which is included in the proposed fiduciary duty.

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