FOREIGN EXCHANGE

Why FX derivative mis-selling disputes rarely go public

BY PAUL GOLDEN
July 30, 2021

Recent reports concerning a payment made by Deutsche Bank to Europe's largest winery are a reminder that disputes over FX derivatives mis-selling have yet to run their course.

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The Financial Times and Bloomberg reported at the end of June that Deutsche Bank had made a payment of more than €10 million to J García Carrión for losses sustained over a period of six years. Euromoney understands that the Spanish firm has also made claims of mis-selling against two other banks. J García Carrión did not respond to requests to comment and Deutsche Bank declined to comment.

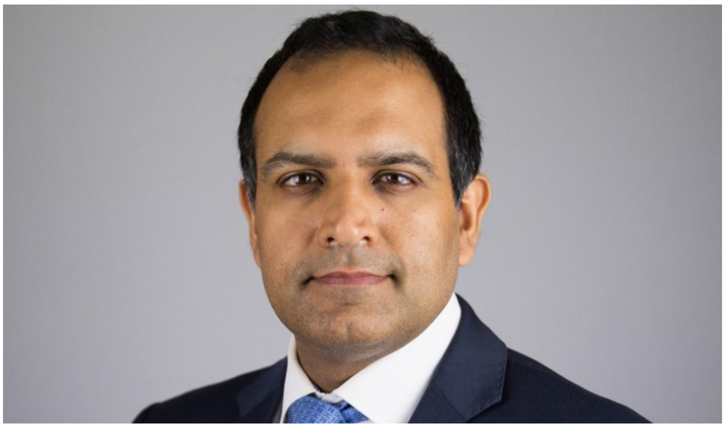
One of the reasons why this case is notable is not the sum involved, but rather that it found its way into the public domain. As Euromoney has previously reported, there are many reasons why the majority of currency derivatives mis-selling claims tend to be settled at a very early stage.

"Customers are still being sold products … and downside

"There have been at least a dozen cases over the last few years where we have helped the client reach some kind of restructuring or settlement with their bank or broker," says Abhishek Sachdev, chief executive of corporate treasury consultancy Vedanta Hedging. "In these situations the solicitors didn't even get involved."

One reason for the relatively small number of cases that have made it as far as the courts is that banks and brokers are concerned about regulators opening a *risk is not always explained correctly"*

ABHISHEK SACHDEV, VEDANTA HEDGING



thematic review or investigation along the lines of the Financial Conduct Authority's review of interest rate hedging products.

According to David McIlroy, head of chambers at Forum Chambers, the limited number of court actions can also be attributed to corporates focusing their energies on other areas during the pandemic. "Unless the outcome of a case means life or death for the business, they have tended to avoid getting involved in proceedings," he says.

In addition, while a large number of corporates claim to have been mis-sold currency derivatives, the bespoke nature of these contracts means a class action-type lawsuit is typically difficult to pursue.

Simon Hart, partner and head of the financial markets disputes team at law firm RPC, observes that limitation periods allow parties six years to bring a claim. "If you then add time for litigation to play through, it can take a significant amount of time to get to judgment," he says. "These cases are very technical, particularly in relation to expert evidence."

The point at which a claim can be made will also depend on what the customer is aware of and when they become aware of it. Depending on the type of product, they may have learned that it did not operate as expected or had unanticipated consequences when the market began to move in a certain way, which could be some time after the product was entered into.

It is often the case that particular moments of volatility in key currency pairs trigger particular features in the product, resulting in immediate leveraged and significant losses, explains Sam Roberts, a partner at law firm Cooke, Young and Keidan.

"For dollar/sterling, the Brexit referendum and the early Covid volatility of March 2020 are two recent examples of significant volatility in a currency pair," he adds. "If a buyer of derivatives was on the wrong side of that volatility, they will then be trying to assess whether the explanation given before the product was sold was sufficient for the bank to have met its obligations."

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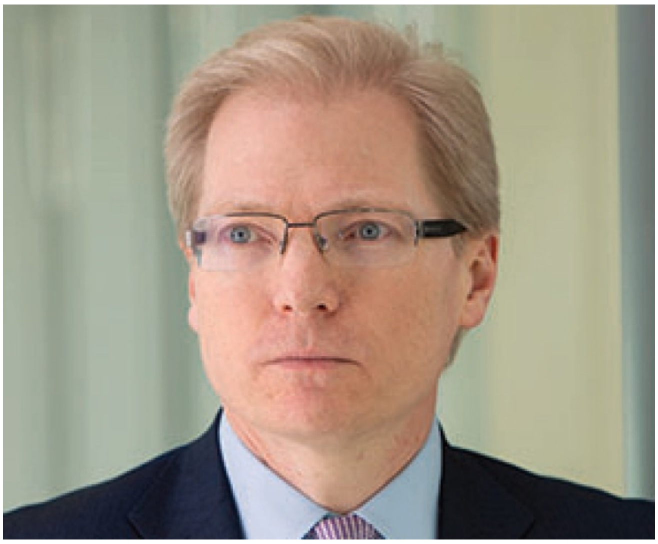
SIMON HART, RPC



Counter-claim

When asked which side these settlements tend to favour, Sachdev says that in many cases the bank or broker will claim monies from the claimant, creating a dispense and counter-claim situation. This could see a broker claiming the client owes it £5 million, for example, and the client denying this and then seeking a further £5 million to cover direct and indirect losses from the trade.

If the case is argued correctly, Sachdev says he would expect the client to receive between 20% and 40% of their claim value.

"Banks are very good at assessing which cases to fight and which cases need settlement, so as to maintain the legal status quo and avoid adverse findings which impact other cases," says Hart. "They will only fight cases they know they can win."

> *"There will generally be brokers willing to step up and sell ... products notwithstanding the litigation risk"*

SAM ROBERTS, COOKE, YOUNG AND KEIDAN

According to Sachdev, banks and brokers have improved some of their practices since the first mis-selling complaints came to light. "However, customers are still being sold products that are more complex than they need and downside risk is not always explained correctly," he adds. "A related issue is how banks and brokers explain the potential negative credit implications of certain long-dated FX derivative structures."

There are some FX options that are so long term or complicated – or both – that even if the trade doesn't go against the client, the fact that they have entered into it means that the company could see its creditworthiness damaged.

Sachdev says there is also price gouging taking place on some options contracts by brokers who feel that they would otherwise be unable to remain viable in a highly competitive market.

Although banks and brokers will almost certainly have changed the way FX derivatives are sold in light of past claims and scrutiny, there will always be a desire to sell products that generate profit agrees Roberts.

"Where banks have stepped back from selling certain FX derivatives due to regulatory scrutiny, there will generally be brokers willing to step up and sell those products notwithstanding the litigation risk it might create further down the line," he concludes.

TAGS FOREIGN EXCHANGE | WESTERN EUROPE | REGULATION | DEUTSCHE BANK

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Paul has written about finance since the early 2000s, with a particular emphasis on foreign exchange, treasury and wealth management. He is a regular contributor to several industry titles in addition to Euromoney.

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