On the Interface Between Financial and Company Law

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Today, as I am writing this editorial, the trail court in Stockholm handed down its judgment in the most talked about director duties case in Swedish history, the 'HQ Bank case'. The case illustrates some of the most topical questions in contemporary corporate governance, especially concerning the financial industry.

The HQ Bank was a Swedish investment bank operating in Stockholm. It was owned by the listed holding company HQ AB, traded at the Nasdaq Stockholm exchange. It had for a series of year been successful and had survived the financial crisis without any apparent problems. However, in late 2009 and early 2010 the Swedish Financial Supervisory Authority began to question the bank's internal capital adequacy assessment and at least indirectly the valuation of its trading portfolio.

The directors and management of the bank engaged in a series of activities to strengthen its position. One expert on valuation of financial assets was appointed to the board of directors of the bank's holding company, but promptly resigned when her recommendations were not acted upon. The bank was, however, recapitalized by a transfer of the holding company's retail fund business to an affiliated company. Simultaneously, its compliance function was reorganized and enlarged and a new managing director was appointed with the explicit task to bring the bank in line with the supervisory authority's requirements.

During the summer of 2010 the optimism among the bank's owners, directors and management rose. The management felt that it had a good dialogue with the officials at the supervisory authority and there was a common feeling that it was underway to overcome its problems.

The executive committee of the supervisory authority was scheduled to have a meeting on 28 August 2010. And in the evening, after the meeting, the bank's managing director got a call from the chief legal counsel to the authority. To the managing director's surprise, he was told the executive committee had ruled that the banks permit was revoked, and that the authority was to apply for a liquidation order early next week. In media there are anecdotal reports about how the managing director got hold of his chairman and the chairman of the most important owner at a white tie function at the Stockholm City Hall and that they still sported white tie attire at the subsequent meeting with the supervisory authority later in the evening.

An administrator was appointed by the court to govern the bank in lieu of its board of directors. It was later amalgamated with another banking and financial service company in Stockholm. The bank's former holding company was, however, still operating under new directors and a new management team. Partly, its ownership structure had changed. The sole aim of the holding company from this point became to bring legal action regarding the purported misconduct of former directors and managers of the bank and its holding company, mainly for breach of duties of skill and care.

Some years later an action for breach of directors' and managers' duties commenced in the trial court of Stockholm. In brief the legal grounds for the action were that the directors and managers of both the holding company and the bank had breached their duties skill and care by mismanagement of the bank's business so that the supervisory authority revoked its licence. In the end the claim against the directors and managers amounted to roughly EUR 600 millions. On 14 December 2017 the trial court ruled that although the directors, managers and statutory auditor of the bank – but not the directors which were only on the board of the holding company – had been negligent, no causation was proven between the neglect and the loss to the bank incurred when the licence was revoked. Most likely the trial court's judgment will be appealed to the Svea Court of Appeal and possibly to the King's Supreme Court.

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The case gives rise to some interesting points on procedural law, which may explain part of the outcome in the trail court. I will not comment further on them, as they are mostly of interest to a Swedish audience. However, some observations of the interface between company law and financial law may be more generally interesting. Before embarking on this discussion, it should be noted that the corporate governance rules in the Capital Requirements Directive IV had not been transposed at the time of the revocation of the licence.

1. DIRECTORS' AND MANAGERS' DUTIES

What are the directors' and managers' duties in a bank in comparison with an ordinary company? Clearly, the leadership of a bank has duties which follow from banking and financial law in addition to company law duties. Such duties include the sustainability, risks and stability of the bank, for instance the compliance with capital requirements. They also include setting up a purposeful organization with compliance and risk management functions adequate to the business. One question which is not dealt with in the European financial legislation is how such specific duties fit in to the corporate liability regime. Could, for instance, directors and managers be liable for breach of duties (as is the case in Sweden) for lack of compliance with banking regulations? Another question is how conflicts between company law rules and banking or financial law rules should be adjudicated.

2. SANCTIONS

Now there are comparably strict sanctions for breach of EU banking and financial law rules which have been transposed into the law of the EU Member States, for instance the sanctions against defaulting companies and leadership under the Capital Requirements Directive IV. How should the interplay between those sanctions and company law liability be perceived – and what would be the ideal solution? For instance, a company and its directors may be simultaneously sanctioned, and then the potential mismanagement of the directors – which has already been sanctioned – may be challenged under company law rules. Does this create and unnecessary strict burden on directors and managers?

3. CORPORATE GROUP LAW

In the HQ case, it was submitted that the directors of the holding company were liable for the mismanagement of the bank (its subsidiary). In my opinion there is a tendency in the EU banking and financial legislation to look upon a financial corporate group as one integrated economic undertaking. But is it reasonable to hold the directors of a parent company liable for mismanagement in a subsidiary, when they do not have any legal power to direct the subsidiary's day to day business?

4. RISKS FOR DIRECTORS AND MANAGERS

There is much talk about a potential brain drain from the financial industry due to unproportionate risks for persons occupying leadership positions. Such risks would include financial and company law liabilities but also the risk of failing future fit and proper tests for those who have been involved in a failing financial institution. I have on occasion advised against accepting directorships in smaller financial institutions due to this risk and I understand that colleagues in other jurisdictions have done the same.

To conclude, there are interesting questions raised by cases such as the HQ case. For scholars of banking, financial and company law as well as corporate governance this will, in my opinion, be one of the most important research areas in the future. I am confident that we will see more cases which highlight the interface between financial and company law in Europe in the coming ten years.