Feature

KEY POINTS

- In early 2019, for the first time, the Securitisation Regulation (SR) imposed direct statutory obligations on certain participants in securitisation transactions.
- The establishment of those statutory obligations raises the question whether claims could, in principle, be brought under English law on the basis of the tort of breach of statutory duty by parties that have suffered loss as a result of breaches of those obligations.
- In light of the Financial Conduct Authority (FCA) and Prudential Regulation Authority's (PRA) powers to apply for or issue orders for restitution, and in the absence of an express legislative intention to confer a civil right of action for institutional investors, the availability of a remedy under the tort of breach of statutory duty for breaches of those obligations is an open question.

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Claims for breach of statutory duty under the Securitisation Regulation?

In early 2019, for the first time, the Securitisation Regulation (SR) imposed direct statutory obligations on certain participants in securitisation transactions. While the SR is policed in the UK by the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA), could it, like the regulatory framework for structured products and payment protection insurance, give rise to civil litigation? This article considers whether claims could, in principle, be brought on the basis of the tort of breach of statutory duty under English law.

LIABILITY IN TORT FOR BREACH OF THE SECURITISATION REGULATION?

The Securitisation Regulation[1] (SR), as implemented in the UK,[2] imposed a host of obligations on originators, sponsors and securitisation special purpose entities (SSPEs) for securitisation transactions issued after 1 January 2019. Specifically, Art 32 SR requires member states to lay down rules establishing administrative sanctions and remedial measures for failure to comply with the SR. In the UK, the Financial Conduct Authority (FCA) and, in some cases, the Prudential Regulation Authority (PRA) are granted wide powers to impose sanctions for non-compliance, including remedial orders.[3]

Previously, obligations relating to risk retention and credit granting were imposed indirectly on originators, sponsors and original lenders by virtue of the Capital Requirements Regulation[4] (CRR) due diligence provisions, which required that EU banks impose contractual obligations on originators, sponsors and original lenders relating to risk retention and credit granting. The entry into force of the SR marked a watershed moment because it imposed statutory duties directly on originators, sponsors, SSPEs and original lenders.

In light of the establishment of those duties, this article considers whether claims could, in principle, be brought on the basis of the tort of breach of statutory duty under English law by parties that have suffered loss as a result of breaches of the SR.

At first glance, this traditional English common law tort may appear as an odd source of redress under today's regulation of financial products. However, investors have had some success in claims for breach of statutory duty in respect of non-compliance with regulations pertaining to structured products[5] and payment protection insurance.[6] In addition, a line of decisions by the English courts and the Court of Justice of the EU (CJEU) has paved the way for claims for damages arising from breaches of EU-derived law in the UK. That makes the tort worthy of investigation in the context of the SR.

THE TORT OF BREACH OF STATUTORY DUTY UNDER ENGLISH LAW

The elements of the tort of breach of statutory duty: the *X (Minors)* test

The tort of breach of statutory duty provides civil redress for persons harmed by other persons' failure to comply with certain statutory duties. In *X (Minors) v Bedfordshire*[7] the House of Lords set out in plain terms the necessary elements of the tort:

- a statutory duty for the protection of a limited class of the public;
- a Parliamentary intention to confer a civil right of action on members of that class;
- relevant harm caused by the breach to an individual falling within the protected class of claimants;
- no alternative remedies available or other indicators of a lack of Parliamentary intention to confer the civil right of action; and
- no application of statutory defences.[8]

Each of the principal elements of the tort is examined below in the context of the SR. It should be noted, however, that the courts will construe statutes narrowly when determining whether there was an intention by the legislature that a breach should be actionable by a harmed individual.

A statutory duty for protecting a limited class of claimant

Where a statute imposes a duty for the benefit or protection of a particular class of persons, and the sanctions imposed under the statute for a breach are inadequate to remedy injuries experienced by a member of that class, the classic view is that the courts will presume that Parliament did not intend such sanctions to be exclusive of a right of action in tort.[9] However, in cases where the duty is to protect the public at large (eg providing a public water supply, or keeping highways in repair), the courts have held that Parliament did not intend for individuals to have a private right of action for breach.[10] In *X (Minors)*,

the House of Lords held that a private law cause of action will arise if it can be shown, as a matter of construction, that the duty was imposed for the protection of a limited class of claimant *and* that Parliament intended to confer on members of that class a private right of action for breach of the duty.

While the SR was adopted in part to promote the resilience of the European financial system following the 2008/09 financial crisis, it was also created to address risks faced by securitisation investors. Recital 9 SR highlights that investors in securitisations are exposed to the credit risk of the underlying assets, as well as operational, liquidity and concentration risk of securitisation structures, and states that due diligence is essential to protecting securitisation investors from such risks.

In order to enable investors to conduct the necessary due diligence, the SR requires that originators, sponsors and SSPEs provide pre-pricing transaction information, ongoing granular performance data for underlying assets, investor reports and ad hoc disclosure of insider information or significant events. Originators, sponsors and original lenders must also satisfy requirements relating to risk retention, credit granting standards and, for eligible transactions, the new simple, transparent and standardised (STS) designation framework.

Article 3 SR states that securitisation exposures are not generally suitable for "retail" investors (eg natural persons and some corporates). However, the pool of potential non-retail investors includes a wide range of institutional investors. In addition, the losses contemplated by Art 33 SR (which empowers national regulators to impose remedial measures for breaches of the SR) are those experienced by "third parties", which is even broader. This raises doubts as to whether the group of potential claimants would be considered sufficiently limited as required under the *X (Minors)* test.

On the other hand, one could argue that the pool of securitisation investors subject to due diligence requirements under Art 5 SR is in fact reasonably well-defined. Article 5 SR requires that institutional investors must, prior to investing in a securitisation, assess the risks involved and be able to demonstrate to their regulator they have a comprehensive and thorough understanding of the securitisation position and its underlying exposures. Recital 12 SR makes it clear that the ability of investors and potential investors to exercise due diligence and make an informed assessment of the creditworthiness of a given securitisation depends on access to necessary information. The statutory definition of "institutional investors" includes EU-established insurance and reinsurance undertakings, institutions for occupational retirement provision (or their investment managers), alternative investment fund managers (AIFMs), undertakings for the collective investment in transferable securities (UCITS) (or their management companies), internally managed UCITS, credit institutions and investment firms.

Recital 9 SR adds that investors in STS securitisations must be able to rely on information provided by originators and sponsors in respect of STS eligibility. The pool of investors that stand to benefit the most from STS eligibility comprise an even smaller pool of potential investors – namely, EU-regulated credit institutions with an interest in obtaining a preferential regulatory capital treatment of STS investments under the CRR.

Ultimately, the process of identifying a protected class of claimant that is sufficiently "limited" so as to open up a cause of action for breach of statutory duty is not straightforward and is likely to turn on the facts of a particular case.

A legislative intention to confer a civil right of action

English courts have been reluctant to find that a particular statute impliedly gives a right of action to a person injured by breaches of duties in that statute if the terms of the duties imposed are too general to allow for direct enforcement by individuals.[11] The prevailing view is that a statutory provision aimed at protecting certain individuals is not of itself sufficient to confer private law rights of action; there should be some further indication that the statute intended for those individuals to have private law rights of action.[12]

The Financial Services and Markets Act (FSMA)[13] provides a scheme of civil liability which includes matters such as the standard of conduct and defences. For example, ss 20(3), 71(1) and 71(2) FSMA create a civil remedy by reference to breach of statutory duty in respect of the carrying out of controlled activities under FSMA. Section 90 FSMA creates a civil liability regime in respect of statements in listing particulars or prospectuses by creating a right to obtain compensation for any person who has acquired securities to which the particulars apply and suffered a loss as a result of any untrue or misleading statement in the particulars or the omission of any required information.

Under s 138(D)(2) FSMA, a contravention by an authorised person of a rule made by the FCA is expressly actionable at the suit of a private person who suffers loss as a result of the contravention, subject to the defences and other incidents applying to actions for breach of statutory duty. It is under this provision that damages were awarded for breaches of the FCA's Conduct of Business Rules and Insurance Conduct of Business Rules, resulting in sales of structured products[14] and insurance policies[15] (respectively) that were said to be unsuitable for certain customers. Paradoxically, the s 138(D) FSMA liability regime incorporates sales of securitisation investments to retail investors, even though Art 3 SR bans sales to retail clients except under extremely limited circumstances.

Article 33(2)(e) SR requires that regulators, when determining the type and level of remedial measures imposed under Art 32 SR, take into account the losses incurred by third parties caused by the infringement, where appropriate. In light of this, it is arguable that the legislative intent was for civil redress to be administered exclusively through the regulatory enforcement regime, rather than by way of private civil cause of action. The question is one of construction, and the starting point, according to Lord Atkin in *East Suffolk Rivers v Kent*;[16] is that the duty imposed by statute is primarily a duty owed to the state, and not necessarily a duty owed to a private citizen.

The duty may, however, be imposed for the protection of a particular class of citizens, in which case, a person of the protected class can sue for injury.

While the FCA has not had cause to publish a specific view on this question, a stated aim of the FCA's Enforcement Guidance Manual[17] is to address some of the harms to investors identified in the securitisation market following the 2008/2009 financial crisis, including the lack of adequate disclosure, and the misalignment between issuers' and investors' interests in securitisation transactions. The Enforcement Guidance Manual grants the FCA the power to require restitution to remedy the harm to investors caused by non-compliance of obligations arising under the SR. Such a regulatory solution to remedy injury to investors suggests a lack of intent to confer a separate, civil right of action. On the other hand, the Enforcement Guidance Manual clearly states that the rules are imposed in order to protect a particular class (ie securitisation investors) which should, according to Lord Atkin's approach to construction, indicate that a civil right of action was contemplated.

Harm caused by the breach to a member of the protected class of claimants

In order to succeed, a claimant must establish an injury or damage of a kind against which the statute was designed to give protection, and that the breach of statutory obligation caused, or materially contributed to, that injury or damage.[18] As with other torts, the damage must also not be too remote.

Investors may struggle adequately to adequately assess the credit risk of a securitisation exposure if they do not have access to timely and accurate data required under the Securitisation Regulation. An unclear or inaccurate risk profile resulting from inadequate due diligence could mean unexpected credit risk or mispricing of investments.

Under the CRR a 1,250% risk weight may be imposed on securitisation investments held by regulated banks where SR requirements such as risk retention are not satisfied. The imposition of punitive risk weights affects the marketability, liquidity and, ultimately, the price of the investments. STS-labelled securitisation products could become ineligible for the STS designation if, for example, an originator, sponsor or SSPE fails to satisfy its disclosure requirements. In addition, a securitisation product could be mislabelled if an originator or sponsor provides a misleading or inaccurate STS notification. If a securitisation loses its STS label or is mislabelled, then institutional investors in STS products could lose the potential benefit of preferential capital treatment.

Where a statute is intended to protect against one manner of loss, the courts will not necessarily allow a claim in respect of a similar (but not identical) loss.[19] The harm can be very specific and the courts are reluctant to extend protection beyond what is expressly stated in the statute. For example, in *Rodgers v National Coal Board* the court held that the defendant was not in breach of statutory duty under the Mines and Quarries Act 1954, which was meant to protect against the risk of falling down a mineshaft from the surface entrance. The claimant's deceased spouse fell down the shaft from inside a mine's entrance (below the surface), which was not the precise risk contemplated by the relevant provision. The claim for damages failed.

The main purpose behind making loan level data, investor reports and significant event reports available on securitisation repositories for "public" securitisations (ie where a Prospectus Regulation[20] compliant prospectus is required) is to provide investors with a single and supervised source of information for investors. Recital 13 SR expressly states this purpose. However, the recital also states that investors in private securitisations are in direct contact with the originator and/or sponsor and receive the necessary information directly from them in order to perform their due diligence. Bearing in mind the fine line drawn in *Rodgers v National Coal Board*, it is possible that the courts might demarcate investors in public securitisations as a class of claimants separate from investors in private securitisations when looking at remedies available for breaches of the SR's transparency requirements more generally.

NO ALTERNATIVE REMEDIES AVAILABLE

If Parliament clearly intended to protect a limited class of potential claimants, then in the absence of a statutory remedy for breach, Parliament must have intended there to be a private right of action; otherwise, there is no method of securing the protection that the statute was intended to confer. In the words of Lord Simonds in *Cutler v Wandsworth Stadium*:

> "... a statutory duty was prescribed but no remedy by way of penalty for breach was imposed; it could be assumed that a right of civil action accrued to the person damnifed by the breach. Otherwise, the statute would be but a pious aspiration."[21]

Under s 382 FSMA, a court may issue an order, when requested by the FCA or PRA, requiring restitution if it is satisfied that a person contravened or was knowingly concerned with a contravention of a requirement of the SR or the 2018 Regulations, and:

- profited from that contravention; or
- caused one or more persons to suffer loss or be otherwise adversely affected as a result of the contravention.[22]

However, the courts are under no obligation to issue the order and the FCA or PRA are under no obligation to apply for one.[23]

Under s 384 FSMA, the FCA or PRA are empowered to order a restitution order for contraventions of the SR committed by a "securitisation regulation unauthorised person" (SRUP). The definition of SRUP includes (among others) originators, original lenders, UK-established persons who set up a third country SSPE, sponsors and third-party STS verifiers. However, the SRUP definition excludes any entities that are authorised to carry on regulated activities with a Pt 4A FSMA permission or equivalent (such as banks). Under s 384 FSMA, the

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FCA or PRA may exercise the power to require the SRUP to pay restitution if the FCA or PRA is satisfied that the SRUP contravened or was knowingly concerned with a contravention of a requirement of the SR or the 2018 Regulations, and profited from the contravention or caused one or more persons to suffer loss or be otherwise adversely affected as a result of the contravention.

There could be a gap where the FCA and PRA decide not to apply for or issue restitution orders, or are unable to do so where the non-complying entity falls outside of s 384 FSMA. Arguably, that gap leaves room for a private action for breach of statutory duty as a last resort for an aggrieved investor (outside of available contractual remedies). It remains an unsettled question whether a decision by the FCA or PRA not to seek restitution means that the remedy ever existed in the first place. That being said, the test in *X (Minors)* is whether an alternative remedy is available at all. If the statute provides some other means of enforcing the duty, that will normally indicate that the statutory duty was intended to be enforceable by those means and not by private right of action. However, the mere existence of some other statutory remedy is not necessarily decisive. Section 382(7) FSMA states:

> "… nothing in this section affects the right of any person other than the appropriate regulator to bring proceedings in respect of the matters to which this section applies."

This provision could support the prospect that Parliament intended there to be a private remedy for the protected class of investors.[24]

BREACHES OF EU-DERIVED STATUTORY DUTIES: STILL RELEVANT?

While the classic common law tort developed in response to breaches of duties under domestic statutes, a separate line of judicial decisions by the CJEU (as endorsed and applied by English courts) developed in parallel for addressing claims for compensation for breaches of statutory obligations under EU-derived law. The CJEU[25] bestowed a duty on national courts of member states to protect rights conferred by the EEC Treaty on individual citizens (which, until the UK's withdrawal from the EU, applied in the UK directly by virtue of s 2(1) of the European Communities Act 1972 (ECA 1972)).[26]

The civil action under the tort of breach of statutory duty was recognised by the House of Lords in *Garden Cottage Foods*[27] to include breaches of EU law. Lord Diplock stated that a breach of the duty not to abuse a dominant position (ie anti-competitive behaviour) in contravention of Art 86 of the EEC Treaty[28] could be categorised in English law as a breach of statutory duty imposed for the benefit of private individuals to whom loss is caused by a breach of that duty. Lord Diplock added that such protection was in addition to the promotion of general economic prosperity in the common market. The corollary of Lord Diplock's categorisation was that a breach of a directly applicable provision of the EEC Treaty was capable of giving rise to a private civil cause of action in English law in a way that was analogous to successive claims for damages under common law for breaches by employers of industrial safety regulations.[29]

In *Factortame No 6*,[30] it was held that an action for damages for an infringement of rights under EU law amounted to a breach of statutory duty and was therefore "an action founded on tort" for the purposes of s 2 of the Limitation Act 1980. Although the term "an action founded on tort" was not defined in the 1980 Act, it was construed to include claims in respect of the breach of a non-contractual duty which gave a private law right to recover compensatory damages at common law.

Damages were initially awarded to make good injury caused to individuals by breaches of EU statutory duties by member states, typically for failure to implement EU law.[31] However, in *Garden Cottage Foods*, the House of Lords accepted in *obiter dictum* the existence of liability in damages to a person who had suffered loss as a result of conduct by a private citizen in breach of Arts 85 and 86 of the EEC Treaty.

The reasoning behind judgments for breaches of EU-derived statutory duties remains relevant despite the UK's exit from the EU. The EU Withdrawal Act states that any question as to the validity, meaning or effect of any retained EU law is to be decided in accordance with retained case law and any retained general principles of EU law. EU-derived law (including retained EU case law), as it has effect immediately before the "IP completion day",[32] will continue to have effect in domestic law on and after the IP completion day.

A CLAIM OF LAST RESORT?

Ultimate noteholders carry most of the risk in a securitisation transaction, and yet they are party to very few transaction documents (especially for widely held, public securitisations). The ultimate noteholders hold a contractual interest in the notes but are not, however, parties to documents such as risk retention side letters and servicing agreements, which typically afford contractual remedies for breach of duty. While security and note trustees create a legal nexus between the issuer and the ultimate noteholders, they may not provide the same tailored remedy as a claim for loss arising from breach of contract.

The SR significantly changed the identity of the participants owing statutory duties in respect of securitisation transactions. However, the basic documentary architecture remained the same. Therein lies the issue – there are no obvious contractual remedies or statutory actions for injury caused to noteholders by a breach of duty arising under the SR. ■

1 Regulation (EU) 2017/2402 (the Securitisation Regulation, or SR).
2 Securitisation Regulations 2018 No 1288 (the 2018 Regulations).
3 Regulation 4(1), Securitisation Regulations 2018.
4 Regulation (EU) 575/2013, as amended (the Capital Requirements Regulation, or CRR).
5 *Haider Abdullah & Ors v Credit Suisse (UK) Ltd & Anor* [2017] EWHC 3016 (Comm) (*Haider Abdullah v Credit Suisse*).
6 *Saville v Central Capital Ltd* [2014] EWCA Civ 337 (*Saville*).
7 *X (Minors) and Others v Bedfordshire County*

Feature

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Council [1995] 3 W.L.R. 152 (*X (Minors)*).

8 While the European Court of Human Rights (ECHR) overturned some aspects of the House of Lords judgment in *X (Minors)* the ECHR also affirmed in *TP and LM v United Kingdom* (28945/95) (*TP and KM v UK*) that *X(Minors)* is the leading authority in the UK on breach of statutory duty.

9 *Groves v Lord Wimborne* [1898] 2 Q.B. 402 (*Groves v Wimborne*).

10 *Groves v Wimborne*.

11 *X(Minors)*.

12 *Reg. v Deputy Governor of Parkhurst Prison, Ex parte Hague* [1992] 1 A.C. 58 (*R v Parkhurst*).

13 Financial Services and Markets Act 2000 c 8, as amended (FSMA).

14 *Haider Abdullah v Credit Suisse*.

15 *Saville*.

16 *East Suffolk Rivers Catchment Board v Kent* [1941] AC 74 (*East Suffolk Rivers v Kent*).

17 EG 19.38, Enforcement Guide (EG) in the FCA Handbook.

18 *Cullen v Chief Constable of the Royal Ulster Constabulary* [2003] UKHL 39.

19 *Rodgers v National Coal Board* [1966] 3 All ER 124 (*Rodgers v National Coal Board*).

20 Regulation (EU) 2017/1129 (the Prospectus Regulation).

21 *Cutler v Wandsworth Stadium Ltd* [1949] A.C. 398 (*Cutler v Wandsworth Stadium*).

22 Regulation 27, Sch 1, para 6 of the 2018 Regulations.

23 Under the FCA's general approach to restitution in EG 11.1, decisions about whether to apply to civil courts for restitution orders under FSMA are made by the chair of the FCA's Regulatory Decisions Committee.

24 *Cutler v Wandsworth Stadium*.

25 *Belgische Radio en Televisie v S.V. S.A.B.A.M.* (Case 127/73) [1974] 1 E.C.R. 51 and *Rewe-Zentralfinanz e.G. v Landwirtschaftskammer für das Saarland* (Case 33/76) [1976] 3 E.C.R. 1989.

26 European Communities Act 1972 c. 68 (ECA 1972).

27 *Garden Cottage Foods Ltd v Milk Marketing Board* [1984] AC 130 (*Garden Cottage Foods*).

28 Article 86 of the Treaty Establishing the European Economic Community (EEC Treaty), now Art 102 of the Treaty on the Functioning of the European Union (2016/C 202/01) (TFEU).

29 *Garden Cottage Foods*.

30 *R v Secretary of State for Transport Ex p. Factortame Ltd (No. 6)* [2001] 1 W.L.R. 942 (*Factortame No. 6*).

31 *Brasserie du Pêcheur SA v Federal Republic of Germany; R v Secretary of State for Transport, Ex p Factortame Ltd (No 4)* (Joined Cases C-46/93 and C-48/93) [1996] QB 404 (*Factortame No 4*).

32 As of the date of publication of this article, the implementation period completion day (IP completion day) is scheduled to take place on 31 December 2020.

Further Reading:

- Private enforcement under MiFID II and MiFIR (2017) 8 JIBFL 485.
- STS: a new age for European securitisations (2019) 1 JIBFL 31.
- LexisPSL: Banking & Finance: Practice note: Securitisation Regulation – essentials.