

Margin calls: banks' obligations towards their private clients

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From the pawnbrokers in the wealthy northern Italian region of Lombardy to the most sophisticated traders on Wall Street, the Lombard loan has endured for centuries. Although the principle has remained identical, i.e. the loan is secured by items of property used as collateral, the system of implementation has evolved and increased in complexity with the introduction of margin calls. Banks have established a common system of margin calls for all clients in their general business terms and conditions. This article aims to provide analysis of the inevitable interaction between these general business terms and conditions and the contractual relationships entered into by the banks and their private clients. The

main argument is that there is no possibility to liquidate any kind of positions (even those that are not intermediated securities) without communicating a margin call to the client under the discretionary asset management agreement and the advisory agreement. Under the execution-only service the same principle applies but is limited to positions that are intermediated securities (subject to Art. 32(1) second sentence of Federal Intermediated Securities Act). The only exception to this principle is when there is an emergency situation or a waiver of the right to be informed of the margin call resulting from the client's conduct.

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Introduction

In the wake of the financial crisis, many clients lost substantial funds due to the use of leverage when trading on margin. This usually involves investors entering into a Lombard loan which is an investment technique for borrowing money from a bank or bro-

ker for the purchase of financial instruments.¹ The term "Lombard" is a reference to the wealthy northern Italian region of Lombardy, where merchants served as pawnbrokers issuing loans secured by all items of personal property used as collateral.² In 1376, the House of Commons of the Parliament of the United Kingdom requested actions against Lombard usurers.³ Nowadays, Lombard loans take a more sophisticated form but remain the same based on this principle. Lombard loans are secured by a pledge of the financial instruments deposited on the clients' bank account. Banks have established margin call systems designed to protect the banks against the risk of their clients becoming insolvent in the event they are unable to repay the bank due to a decrease of the market value of the pledged financial instruments. If the financial instruments held on the account decline in value, so does the value of the collateral supporting the loan. As a result, the bank may take action when certain limits are reached and issue a margin call or directly sell part or all of the financial instruments held on the account.

¹ For an overview on Lombard loan see *Rolf H. Weber*, *Berner Kommentar, Das Darlehen*, Articles 312–318 OR, Berne 2013, p. 222 ff.

² *Joel Mokyr* (ed.), *The Oxford Encyclopedia of Economic History*, Oxford University Press 2003, p. 178. See also <<http://www.chapesjpl.com/what-pawnbroker/>>.

³ *Gwen Seabourne*, *Royal Regulation of Loans and Sales in Medieval England: "Monkish Superstition and Civil Tyranny"*, Woodbridge, Eng./Rochester, N.Y. 2003, p. 65.

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