English summary

Towards a better resolution of duty-of-care claims on financial markets

A PhD research to provide a contribution towards a better resolution of duty-of-care claims to help prevent the risks for society

Mrs B. van Hattum (LL.M.) (Ph.D.)

Introduction

Imminent or pre-existing duty-of-care claims (*zorgplichtclaims*) form the object of this book. These claims may arise from substandard financial products that were offered and/or recommended on a large scale to retail clients of a bank or an insurer (for instance, to consumers and small business parties such as independent contractors and SME enterprises). These claims are the driver behind a range of affairs on the financial markets. Worth mentioning within this scope are the Share Lease Affair (*Aandelenlease-affaire*), the Investment Insurance Affair (*Woekerpolisaffaire*), the DSB Affair, the Interest Rate Swap Affair (*Rentederivatenaffaire*), and the recent Penalty Interest Affair (*Boeterente-affaire*). These affairs contribute to ongoing mistrust regarding the functioning of the financial enterprises concerned, which may even lead to instability risks on the financial markets – the worst case scenario being several financial enterprises going bankrupt simultaneously or shortly after each other. This is why it is in everybody's interest to rapidly find solutions for the problems concerned. Duty-of-care claims with accompanying risks (hereinafter referred to as: 'claim risks') will never fully become a thing of the past, in spite of increasing better supervision. This is because the risk of the development of duty-of-care claims on the financial markets cannot inherently be completely eliminated. After all, the risk that duty-of-care claims will develop is fundamentally connected to the development and innovation of financial products and services. The market of financial products and services would simply come to a grinding halt if the legal framework for law enforcement was watertight. In addition, a difference in normative conceptions among the existing actors in the playing field of duty-of-care claim resolution also contribute to the development thereof. The permanent nature of risks and the differing normative conceptions among actors in the field, as to the desirable allocation of responsibilities when dealing with these risks, raises the question how to design practical solutions and concrete measures for the resolution of existing duty-of-care claims and the prevention of new ones to the extent possible. It is this question, which I have defined as follows, that lies at the heart of this book:

How can (imminent or already existing) duty-of-care claims by consumers and small business parties be resolved in a manner that is in line with the theories of action of a variety of stakeholders in the playing field and that will mostly eliminate the chance of claim risks?

Research approach

I have carried out the research on the basis of an interdisciplinary investigation, by making use of a combination of classic legal desk research and empirical research to the functioning of the Dutch legal framework regarding the resolution of duty-of-care claims. I combined legal desk research with empirical research methods because of my experience during my PhD research, that legal desk research – primarily an in-depth study of literature and case law – could not provide sufficient solution prospects for the problems of duty-of-care claims. The reason for this is that in the current resolution system there is no 'problem owner' who has sufficient leverage to single-handedly push solutions through. Whatever solutions may be conceivable, it becomes crystal clear that these would have to be realised by mutual agreement between a vast number of actors. An understanding is, therefore, required of the legal considerations concerning the problems and opinions on solution approaches of the various actors. In order to achieve this insight, as a basis for the definition of solution approaches supported by the actors, I have carried out a responsive evaluation in addition to classic legal desk research by using the method of the so-called fourth-generation evaluation. Characteristic for this method, which I will hereinafter refer to as: 'the responsive evaluation method', is that the viewpoints of various stakeholders on a specific problem are the starting point for organising the process

of knowledge production, in which the researcher plays both an analysing and mediating role. In order to make this method - which was developed for educational evaluation by Guba and Lincoln (Guba & Lincoln 1989) - suitable for research into possibilities for the resolution and prevention of duty-of-care claims, I have made use of an adaptation of the method developed by Grin, Van de Graaf and Hoppe (Grin, Van de Graaf & Hoppe 1997). One of its elements is mapping out the actors' theories of action. The theory of action by an actor is the set of normative starting points, theoretical insights and practical considerations based on what specific course of action an actor chooses under different circumstances. By making the theory of action more explicit, the researcher gets a better understanding of the problem definitions applied by a specific certain unique actor group (for instance, insurers, supervisors, or claim entities) concerning a specific issue, as well as the opinion of that group regarding specific solutions. In addition, making the theory of action more explicit will lead to an understanding of the values, standards, and generic assumptions used by actor groups when making choices concerning the desirability and acceptability of specific problem-solution combinations. Based on this methodical elaboration, I have distinguished 7 different actor groups in my research. These actor groups were in turn subdivided into various sub-groups of actors. From most actor groups I then selected and interviewed participants. The obtained data from this formed the basis of my in-depth analysis and the reconstruction of the theories of action per actor group. Presented, I submitted the findings on problem perceptions and possible solutions to stakeholders for reflection and completion, by organising a joint workshop attended by members of the individual actor groups.

Understanding the scope of negotiation

The normative considerations of the actors involved

By using the aforementioned research approach I could obtain an understanding of the problem definitions of each of the actor groups that are relevant for the definition and accomplishment of solutions for claim risks, as well as of their opinions on specific solutions for the problems they defined. Within this scope, I have mapped out the normative considerations per individual actor group. These normative considerations consists of: (i) the juridification of society, (ii) the existence or absence of a claim culture, (iii) the idea in society that there should not be any bad luck by allowing and promoting collective compensation schemes ("*pech-moet-weg-gedachte*" or the "Abolish bad luck" concept), (iv) the retail-client's own responsibility, (v) increased access to justice, (vi) the existence of a need for tailor-made solutions on a micro or macro level, (vii) the autonomy of litigants, (viii) interference by the authorities in duty-of-care claim resolution, (ix) mixing private law and public law, and (x) the possible preventive effect of duty-of-care claims on the conduct of financial enterprises.

The three leading opinions (mindsets) on damage and loss of reputation

These predetermined normative considerations I linked to an analysis originating from literature of Ewald 2002, Pieterman 2008 and Kortleven 2013 on risk perceptions of the conceptual developments in the Netherlands about ideas regarding 'damage and loss of reputation'. The analysis of literature about 'damage and loss of reputation' covers a period between 1838 and the beginning of 2013. During this period of time a transition took place from an early-modern guilt culture to a modern risk culture, and subsequently to a postmodern precautionary culture. Contract law, and the liability law forming part thereof, was developed at the end of the nineteenth century in a time when the early-modern guilt culture was the dominant culture, the own responsibility of unfairly treated clients was the key element, and when unfairly treated clients were initially held responsible for the damage they themselves suffered from buying a substandard product. The guilt culture may be characterized by the motto 'Everyone is responsible for his/her own damage'. An unfairly treated client can only claim damage from the party causing the damage if, in a legal sense, a wrongful act (tort) or breach of contract was applicable. Later, as a consequence of the advance of socialism, the risk culture emerged. This culture is characterized most of all by the motto 'Abolish bad luck'. In this culture, not the individual's own responsibility for damage played a central role, but compensation for damage, which has now become a collective responsibility. Compensation for 'bad luck' is achieved for the first time on a collective level through public law, for instance with the introduction of the Dutch Accidents and Injuries Act in 1901 (*Ongevallenwet 1901)*. After all, politically sensitive liability issues cannot be publicly scrutinized in this way, while at the same time damages need to be compensated. The primary

responsibility for the prevention of damage thus rests with the provider of the products and/or services. The risk culture ultimately enabled collective settlement of damages via the introduction of mass claims and the Dutch Act on Collective Settlements (WCAM), which was introduced in 2005. In the risk culture, choices concerning compensation are based on (scientifically) well-founded analyses. Finally, in the early 1980s yet another culture emerged: the precautionary culture. In this last culture, the cause of damages was not blamed on an unfairly treated client, nor were damages regarded as bad luck that ought to be mitigated or eliminated by a collective form of compensation. Instead, in the precautionary culture a system administrator such as the State or a supervisor is held responsible for the development of the problems of damage, because that system administrator failed to prevent this type of the damage. In the precautionary culture, choices for resolution of duty-of-care claims are not always based on (scientifically) well-founded analyses due to an aversion against the influence of experts. In today's society, elements from all three cultures are still present, and sometimes one culture, sometimes the other culture, becomes the dominant factor among actors and actor groups when taking positions on the development and resolution of duty-of-care claims. A concrete elaboration of these cultures can be seen in the extent to which a retail client of a financial enterprise, for example, is deemed to be responsible for any suffered damage. Seen from the perspective of guilt culture, the retail client is held responsible for the development of damage, who never ought to be compensated for compensation of the entire amount of the incurred damage. This idea that damage is an unavoidable effect of the functioning of financial markets which ought to be compensated at all times, preferably collectively, is based on a reasoning dating from the second mentioned risk culture In short, the idea that system administrators (a supervisor or the State) may be demanded to (help) resolve duty-of-care claims, because they are deemed to be responsible for prevention of the damage concerned, is based on considerations from the precautionary culture.

Combining the analysis of the normative considerations with insights of literature about the three mindsets on damage and loss of reputation

Seen against the backdrop of the three cultures identified, I have established that the core principles of Dutch contract law are based on the guilt culture, such as the own responsibility of unfairly treated clients and the willingness to settle conflicts on an individual basis only. Today, these principles are subject to discussion. The principles that are geared more towards the risk culture, such as thinking with the public interest at heart and a focus on reduction of 'bad luck' or damage, are to a greater or lesser degree met with goodwill. From this perspective the legal framework drafted in the 1980s and 1990s for the self- development of a practice for collective resolution of duty-of-care claims and culminating in the enactment of the WCAM in 2005 - instead of individual resolution only - is perfectly understandable. Also the ever further-reaching protective attitude of adjudicators, policy influencers, or decision makers targeted at consumers – i.e. in the opinion of banks and insurers participating to my research, including but not limited to a specific supervisor – is easier to understand. According to the participants for my research, the protective attitude consists of the increase in the number and/or the amount of the awarded damage compensations. I have also established that the idea of 'own responsibility' as a fundamental principle in the current legal framework is criticized from another angle than that of a legal perspective. The participants learned the critical lessons concerned, compared to the idea of the 'own responsibility', *inter alia* from behavioural-economic concepts that would prove that man is not a *homo economicus* who makes rational choices after all. Yet, should this in fact be the case, consumers cannot simply be held accountable in all cases for their own responsibility in the development of damage, as was the reasoning. The insights of behavioural-economic science related to damage issues, could have implications for draft policies (legislation) and for the execution of the practice focused on resolution.

Linking the answers of respondents about their normative preferences with the broad categorisation of 'risk cultures' from literature provides more transparency into the motives, and thus the choices, regarding solutions for the duty-of-care claim problems. More transparency helps to create more practical elements to use in the concrete elaboration of (future) solutions as well. According to my analysis of the interviews, three overall solution approaches can be defined for the resolution and prevention of duty-of-care claims. By comparing these three solution approaches with the results of the classical legal desk research, an elaborate analyse can be utilized to establish specific courses of action. Thus, this analysis will lead to a better understanding of the manner in which (imminent or already existing) duty-of-care claims of consumers and

small business parties can be resolved, according to the actors involved, by means of practical and policy adjustments in the resolution system, and the manner in which the chance of claim risks could be eliminated for the most part.

Conclusions

Conclusions focused on the Dutch actors involved

The results of the research indicate that the legal framework in the Netherlands does not provide sufficient resolution possibilities. Because of this neglect, the framework has to be changed by making it more streamlined and controlled, in order to allow for a sustainable result. Such a result is especially important to limit the claim risks concerned as much as possible, and in order to be able to settle deadlocked duty-of-care claims once and for all. The participants for my research pointed out that the applicable legal framework contains elements that have a delaying effect on the proceedings. They also feel that the framework is at odds with the interest of unfairly treated clients to receive compensation for suffered damage, as well as to provide clarity about their financial future in the shortest possible term. Furthermore, financial enterprises such as banks and insurers might abuse the current complex legal framework by financially and psychologically 'smoking out' complainants, as it were. Literature presents examples of clear-cut causes, aside from the possible delay tactics deliberately applied by defendants. For instance, according to Brenninkmeijer *et al.* 2015, these can be found in the financing model of lawyers and courts of law with respect to their role in the dispute resolution. There is also to varying degrees a threshold when it comes to access to justice. Furthermore, the participants among various actor groups, such as banks, insurers, adjudicators, and supervisors, lack the required expertise to achieve the desired results in the resolution. The participants attributed this shortfall of required expertise in particular to missing knowledge and experience in the area of interaction between private law and public law regarding the prevention and resolution of duty-of-care claims. Participants mentioned also that the problem of too little expertise is a problem among supervisors and adjudicators because their missing knowledge regarding the effect and composition of the products and services concerned. In addition, the participants link this lack of expertise to prevent and deal with duty-of-care claims to the results in the decision-making process, the organisational structure, and to, for instance, the applied strategy of law enforcement and informal influencing by the sub actor and actor groups concerned. According to the participants, better results could be achieved if experts would be involved in a different way in the (process towards a) decision, risk assessments, and applicable supervisory strategies. To gain a better control on the resolution process, the participants expressed that they preferred to limit the group of *opt-outers* in a collective settlement, because the uncertainty regarding the size of this group contributes to risks that are difficult to accurately quantify. The participants also request that something has to be done about the sometimes unprofessional conduct of claim organisations, which forces banks and insurers to pay unnecessarily high transaction costs, i.e. negotiations on frivolous claims that nevertheless need to be negotiated by the banks and insurers to prevent or minimise harm to their reputation. Please note that the conduct of claim organisations is not always in the best interest of the unfairly treated client represented by them, allowing for these persons to suffer additional damages as a result. In addition, the participants pointed out that achieving an arrangement is hampered by fear for damaged reputations and liabilities among direct policy influencers or decision makers. Mutual considerations of competition between insurers or banks can prevent them from reaching a settlement as well. Furthermore, making errors during the resolution process is precarious, because a minor mistake can easily have major (prudential) effects on the organisation, which in turn may send a less than desirable message to other companies and business sectors. Finally, participants indicated that a safeguard of public interests in the resolution of duty-of-care claims was missing. A duty-of-care claim is not only about the interests of direct stakeholders and/or litigants, but may have a huge impact on the financial position and status of 'healthy clients' of financial enterprises, investorsof pension funds among others, and in some cases the taxpayers. The current legal framework lacks the adequate set-up to take these public interests into account in a resolution result.

During my interviews and the workshop that I organised in November 2013, the participants for my research mentioned a variety of solutions for the main sticking points found in all three methods, from which I was

able to distill three comprehensive solution approaches. Based on my analysis, it is likely that these solution approaches will be met with a broad support among all actor groups.

1. Granting more leeway to claim organisations by giving them the option to conduct a collective-action for damages, yet the precondition is that these organisations will be further regulated.
2. Striving for a supervisor who operates progressively and creatively in the area of duty-of-care claims.
3. Safeguarding expertise within all actor groups in the playing field of duty-of-care claim resolution.

The actors did sometimes commentate on these potential solutions by discussing the options thereof. However, when it came to further elaboration of the options they often held different opinions. Sometimes, no concrete explanation was submitted for a different approach.

In spite of the fact that the actors in the field of duty-of-care claims were not able to present detailed solution approaches, my research shows that it is still possibleto define more concrete solutions for the duty-of-care claim problems. This is possible by studying the three cultures of damage and loss of reputation in relation to the normative considerations of the actors involved, followed by comparing these with the results of the responsive evaluationabout the functioning of the resolution system of duty-of-care claims. By working in this manner, it becomes possible to draw overall conclusions that individual stakeholders would not be able to draw. Finally it becomes possible to formulate suitable recommendations to change the practice and the legal framework of preventing and resolving duty-of-care claims specifically.

Conclusions applicable to actors operating all over the world regarding preventing and revolving duty-of-care claims

The results of the research broadly show that private-law resolution ought to be the starting point in a bid to optimize the preventive effect of contract law. An outcome that too is relevant for actors outside the Netherlands, so to resolve duty of care claims all over the world. Transparency regarding (the cause of) complaints and the impossibility for (potential) damage inflictors to shirk liabilities must be enshrined in the legal framework that facilitates private-law resolution. Interaction with public law and a corresponding duty for a supervisor is the second conclusion of this research. How far-reaching supervisors ought to be able to intervene in the private-law framework will be determined by the choices to be made in the negotiation processes regarding the extent of transparency and the ability to ‘pass the buck’ when it comes to liabilities. Negotiation processes are influenced by normative considerations that differ per country, and as a result the mix between private law and public law can also be different per country. Finally, the effects of this mix can be controlled by anchoring expertise in the playing field in the area of these claims, and adjoining areas of expertise such as product development, risk management, the effect of contract law, and private-law and public-law duties to provide due care. This calls for adjustments in the organisational structure and (supervisory) strategy of, and the contacts with, experts by the actors involved. Such adjustments will also ensure that organisations will conform themselves to the spirit of the times we live in, which will enable continued innovation and an optimal use of growth potential.