Market price in the event of forced closure of foreign exchange positions

Topic: **Foreign exchange trading** Case number: **2019/22**

The client had a large number of foreign exchange positions in currency pairs at the bank, which were affected by a so-called "flash crash" on 2 January 2019, i.e. a short-term lack of liquidity in the foreign exchange market, which led to strong price fluctuations. Since, according to the bank, there was no longer sufficient margin cover for the open positions, these were largely closed automatically at a loss. In the client's opinion, the Bank had used prices that deviated significantly from market prices in order to calculate the margin coverage and the resulting forced closure of his positions. He demanded the restoration of his positions or compensation in the amount of the loss he had suffered. No solution could be found in the ombudsman procedure, as the Bank was not prepared to meet the client to a significant extent. The Ombudsman had to close the case, although the Bank was unable to convince him that it had acted correctly.

The customer complained to the Bank about what he considered to be inappropriate prices and had compiled a list of prices published by 11 different brokers for the same currency pairs at the same time. These prices differed between 670 and 850 PIPs (percentage in points) to his disadvantage from those used by the bank for the forced sale. He asked the bank to disclose what prices it had received for the positions with its liquidity providers. In addition, he demanded the restoration of the positions or compensation for the damage he had suffered in the amount of almost EUR 5,500.

The bank decided that at the time in question, with very limited market liquidity, only one of its liquidity providers had quoted prices for the currency pairs under discussion, albeit with substantially increased spreads. The client's positions had been liquidated at these prices, plus a normal markup. These had been market prices. Since the bank was the customer's direct counterparty, as is customary in Forex business, and the transactions were carried out on the basis of the law on sales contracts, the bank was not required to disclose the prices received from its liquidity provider. It would only have had to do so if it had acted as commissioner in the transactions. However, due to its good customer relations, it was able to negotiate a discount with its liquidity provider retroactively for those customers who received particularly bad prices in connection with the "flash crash". For this reason, it was in a position to meet the customer to the extent of approximately EUR 190. The customer was not satisfied with the offer and contacted the Ombudsman. He maintained his demands and took the view that the bank should have stopped trading when only one of its liquidity providers had set prices at all, which, however, deviated so far from other prices available on the market, and should not have taken these bad prices into account.

In its opinion to the Ombudsman, the Bank maintained its position. It stated that there was no central market in forex trading in which binding prices for currency pairs were formed. Forex transactions were bilateral transactions in which the Bank acted as a direct counterparty to its customers. This was important in order to understand the mutual rights and obligations between the Bank and its customers, which it has fulfilled in every respect in the present case. Price differences between individual providers were normal. The price overview submitted by the customer was therefore irrelevant. Moreover, it was unclear whether any transactions had been carried out at these prices.

The customer had relied on an external algorithm and, by opening many small positions with a high degree of leverage, had exposed himself to the typical risks of the Forex business, including liquidity dried up in a “flash crash” and sudden, high price fluctuations. It would not have been appropriate to stop trading, as this would only have been possible in the event of much more serious events, such as the Swiss National Bank’s January 2015 decisions regarding the EUR floor. Moreover, a suspension of trading would also have affected clients who could have made profits on their positions. Finally, it stressed that there was no “fair price” theory in Swiss law and that, on the basis of the applicable contractual principles, it was not obliged to obtain the best possible price for the client. On the contrary, in such a situation, it was entitled to accept any price offered by one of its liquidity providers, since this was always a market price. This was the case even if only one of the liquidity providers remained, which were usually large, internationally active banks. It reiterated its willingness to pay the client EUR 190 and stated that this was a purely commercial gesture which would not subsequently alter the prices obtained in the forced sale.

As a neutral mediator, the Ombudsman must respect the credibility of the parties. A detailed clarification of the controversial market conditions and the prices traded at the time in question for the currency pairs in question cannot be the subject of the ombudsman proceedings. However, it is of the opinion that a customer in this situation is entitled to treatment that is fair and free from arbitrariness. It should be borne in mind that the Bank is in a conflict of interest and that the customer will no longer be able to choose between prices from different providers in the event of a forced sale. The law on sales contracts to which the bank referred in the present case refers to the concept of the market price as the price which market participants pay or obtain for a certain good at a certain place at a certain time in regular transactions. As a rule, a market price cannot be precisely determined, but moves within a range. In the Ombudsman’s view, if only one liquidity provider is offering prices, the market price cannot be determined on the basis of such an offer alone, but the offers of other participants would have to be considered. Moreover, the Ombudsman was unable to find any provisions in the bank’s Forex contract that would have justified the bank’s concrete action. Since the bank was not prepared to make any concessions even after several exchanges of correspondence, the Ombudsman had to close the case with a notice to the customer and, in the event that the customer wished to pursue his claims further, to refer him to the ordinary courts.