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Financial Services and Consumer Protection

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The term 'financial services' in EU consumer law is broad. It encompasses consumer credit, investment services, banking and payment services, and since recently also retail mortgage credit.[1] Although regulation is focused on such specific areas and therefore comes across as scattered, some common threads can be discerned that explain and connect the EU's policy in financial services law. This chapter will discuss the EU's financial services regulation by exploring its legal framework, its goals (access to finance and substantive protection) and the detailed rules in two selected areas: credit and investment.[2]

It is noteworthy that this chapter is published at a time when European financial policies are strongly influenced by austerity measures taken in response to the financial crisis of 2008. Many of the EU Member States' economies are still in recession. Overall the attitude towards EU cooperation and the financial markets has taken a turn towards greater control of risks. This policy change has a direct effect on consumer access to financial services and on policies relating to consumer protection. Throughout the chapter, note will be made of initiatives that are taken in order to enhance the governance of the financial markets. A question running through the chapter is whether such strategies should be adopted as a long term goal for the EU retail financial market. There are indications in regulation theory that support the view that the interventionist approach that is currently adopted in EU regulation should be loosened in a longer term policy strategy for the EU market.[3] That is a broad question, which of course is intricately related to the chosen economic framework underlying the financial system. Although existing paradigms have been challenged, e.g. neoliberalism,[4] further research is needed to determine which policy choices would best serve the interests of the supply and the demand side of the market. This chapter will indicate where such regulatory problems currently arise.

Seeing the immense diversity of financial services in the EU and the corresponding fragmentation of legislation, this chapter can only give a bird's view overview of the field. It is structured as follows. The first part gives a brief map of the areas of law – public, private, self-regulation – in which EU financial services regulation is situated. Part two discusses one of the goals of EU financial services law, which is to create access to finance. The other goal, substantive consumer protection, is dealt with

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[1] Directive 2014/17/EU on credit agreements for consumers relating to residential immovable property [2014] OJ L60/34, recitals 30 and 31. The Directive was adopted on 4 February 2014 and should be implemented by the Member States by 21 March 2016.
[2] For an overview of relevant materials see also Hans-W Micklitz, Jules Stuyck, Evelyne Terryn, Dimitri Droshout (eds), *Cases, Materials and Text on Consumer Law* (Hart Publishing, Oxford 2010), chapter 6.
[3] On regulatory innovation in the EU see Niamh Moloney, 'The legacy effects of the financial crisis on regulatory design in the EU' in: Eilís Ferran, Niamh Moloney, Jennifer G Hill and John C Coffee, Jr (eds), *The Regulatory Aftermath of the Global Financial Crisis* (CUP, Cambridge 2012), 111.
[4] See e.g. Therese Wilson (ed), *International Responses to Issues of Credit and Over-Indebtedness in the Wake of Crisis* (Ashgate, Farnham 2013).

in parts three and four with specific focus on consumer credit and investment. Part five considers the question to what extent EU legislation on consumer credit and investment, which is aimed at 'full harmonization', prevents further regulation through private law in the national laws of the Member States. The chapter closes with an outlook to future legislative initiatives and an assessment of the post-crisis attitude of the EU legislature to regulation in the consumer financial services market.

1. Two domains and two goals

EU legislation on financial services straddles the domains of public and private law. On the one hand it relates to contracts between consumers and providers of financial services. Most of these transactions are governed by contract law – of EU origin but mostly of national origin – or on occasion by tort law or the rules of precontractual liability. From the perspective of contract law party autonomy is paramount and parties are therefore primarily responsible for their own conduct and decisions.[5]

On the other hand, it is well-established that the law seeks to protect contracting parties who are regarded as weaker, e.g. because of a lack of information or a lack of bargaining power. To this end, regulation through public law seeks to ensure that consumers have minimum rights to information or that they are protected in alternative ways, such as through warnings.[6]

Besides the rules of private and public law laid down in national laws and in EU legislation, private actors increasingly play a large role in norm-setting through self-regulation. Banks and other providers of financial services are subject to guidelines set by themselves or by industry representing bodies, by internal guidelines, model laws, and codes of conduct.[7] Although there are indications that self-regulation is on the wane after the crisis and more faith is put in public regulation to control the financial markets,[8] self-regulation has advantages that make it hard to put aside as a tool for regulatory design. Regulation by private actors often occurs in a specific industry in which the norm-setters themselves have technical expertise. Norms are therefore often fitting to the industry and more easily accepted by its participants.

Private actors, however, often have to rely on State authorities for the enforcement of guidelines or other 'soft law' products and, therefore, self-regulation is for its enforcement and implementation largely still dependent on government structures.[9] The focus of this chapter will be on the regulation of consumer financial markets through 'hard law'. The question is what EU law adds to the regulatory framework for financial services, for which most rules still are laid down in domestic laws. Two goals stand out: to create access to finance, and to achieve a minimum level of consumer protection through rules that apply throughout the EU.

2. Access to finance

[5] An interesting collection of papers on this topic is Stefan Grundmann, Wolfgang Kerber and Stephen Weatherill (eds), *Party Autonomy and the Role of Information in the Internal Market* (De Gruyter, Berlin 2001).
[6] See e.g. the information and warning duties in Art. 19 of the MiFID, Directive 2004/39/EC on markets in financial instruments [2004] OJ L145/1.
[7] Iain Ramsay, *Consumer Law and Policy* (3rd edn, Hart, Oxford 2012) 92-93; Niamh Moloney, *How to Protect Investors: Lessons from the EC and the UK* (CUP, Cambridge 2010) 104-106.
[8] Moloney (n 7) 104.
[9] Chris Brummer, *Soft Law and the Global Financial System* (CUP, Cambridge 2012) 102.

As a first goal, EU financial services policy is aimed at creating access to finance for all EU citizens. It is increasingly acknowledged that access to finance is an essential condition for consumers to take part in society and to establish or maintain a certain standard of welfare. The simple fact of having a bank account can be essential for having access to jobs, pensions and social security systems.[10] Although the numbers in developing countries are more outspoken, it is a mistake to believe that the lack of access to finance is mainly a problem of those countries.[11] In Europe a large number of in particular vulnerable members of society, such as those without income, also do not have access to a basic bank account or a current account. It is estimated that in the EU over 30 million individuals over the age of 18 do not have access to a bank account.[12] These so-called 'unbanked' can be excluded from society and miss out on opportunities that others do have.[13]

Access to finance includes opportunities to obtain credit or to invest, but also savings accounts and current accounts. The exact circumstances under which individuals have access to such services may differ from one Member State to the other. A task for the EU is to try and harmonize these circumstances.[14]

In the field of banking and payment services the EU has taken several initiatives to establish access to basic banking services in all of the EU Member States. An initial study carried out under the aegis of the European Parliament indicated that as many as 15 of the (then 27) Member States did not have some sort of legal regulation to secure access to basic bank accounts, either through legal requirements or through a voluntary code.[15] A Recommendation from the European Commission has been issued to tackle this problem. It sets out general principles for the provision of basic payment accounts in the Member States. It operates in conjunction with the Payments Services Directive,[16] which has been adopted as a means to create a single European market for payments. The Directive is intended to operate in combination with a simplification of bank transfers through the creation of a Single European Payments Area (SEPA).[17] In July 2013, the European Commission adopted a payment legislative package which aims to improve the payments framework in the EU. It includes proposals for a revision of the Payment Services Directive (PSD2) and a Regulation on Multilateral Interchange Fees (MIFs).[18]

For credit and investment services in the EU a similar pattern can be observed. EU law has sought to enhance access to financial markets through legislation aimed at providing a 'passport' to providers of financial products to access EU markets other than their own national market. Examples of this approach in investment law can be

[10] IMCO Report on Basic Banking Services (2011), available at http://www.europarl.europa.eu/document/activities/cont/201111/20111118ATT31909/20111118ATT31909EN.pdf, pp 18-19.

[11] Studies on access to finance mainly focus on developing countries or emerging economies; see e.g. 'Finance for All?' (World Bank Policy Research Report 2008); OECD, 'Access to Financial Services in Emerging Powers: Facts, Obstacles and Policy Implications' (2010).

[12] IMCO Report (n 10), 7.

[13] See also HM Treasury, 'Financial Inclusion, The Way Forward' (2007); Micklitz c.s. (n 2), 375-76.

[14] The degree of harmonization may vary, see part 5 below.

[15] IMCO Report (n 10), 7.

[16] Directive 2007/64/EC on payment services in the internal market [2007] OJ l319/1. See also Regulation 924/2009 on cross-border payments in the Community [2009] OJ L266/11.

[17] http://ec.europa.eu/internal_market/payments/framework/.

[18] Proposal for a Directive of the European Parliament and of the Council on payment services in the internal market (COM)2013 547 final; Proposal for a Regulation of the European Parliament and of the Council on interchange fees for card-based payment transactions (COM)2013 550 final.

seen in the Markets in Financial Instruments Directive (MiFID) and in the UCITS Directive.[19]

Consumers however need more than just access to markets. Another goal of EU law is to lay down substantive rules for the protection of consumers as weaker parties to a transaction. The rules that have been developed so far are mainly regulatory in nature – placing duties on service providers to comply with information requirements – whilst issues of contract or tort have been left to the laws of the Member States. This mix of regulation and private law seems to be constantly under construction. One important influence on the way we regard regulation is that behavioural sciences have changed the way in which we look at consumer decision-making. Another is that the existing regulation, with its emphasis on information duties, did not prevent the crisis nor other instances of mass losses to consumer-investors or credit takers. I will elaborate these thoughts on regulatory design by discussing first consumer credit regulation in the EU (part three) and second consumer investment (part four).

3. Credit

Consumer credit has been regulated in EU law through the Consumer Credit Directive.[20] This Directive aims to harmonize the rules that apply to consumer credit contracts with a particular view to enabling cross-border credit contracts. A first Directive was adopted in 1987.[21] It has since been repealed and replaced with an updated set of rules in 2008.

The EU legislature, as it does in other areas too,[22] has sought to create a general framework of protection based on information duties. This policy corresponds with the notion developed in economics that consumers mostly do not have all the information that traders have and are therefore in a bad position to assess risks and to make sound decisions about their purchases of financial (and other) products. Information duties imposed on sellers or service providers are meant to take away this information asymmetry, or at least to diminish it.[23] The same policy underlies EU legislation concerning misleading advertising or unfair commercial practices.[24]It should be noted that because of the limited scope of the Directive many aspects relating to the agreement will be governed by national private laws.

To achieve transparency and comparability of products, the Directive stipulates that consumers are entitled to receive certain information prior to concluding the contract. The information requirements that are imposed on credit providers ('creditors') and intermediaries are laid down in Articles 5 and 6 of the Directive. The primary information that consumers are entitled to get relates to the cost of credit. Providers should specify the annual percentage rate of charge (APR) applicable to the credit, which should be determined in the same way throughout the EU.[25] Also, other

[19] Directive 2004/39/EC concerning markets in financial instruments (MiFID) [2004] OJ L145/1; Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] OJ L302/32.

[20] Directive 2008/48/EC on credit agreements for consumers [2008] OJ L133/66.

[21] Directive 87/102/EEC concerning consumer credit [1987] OJ L42/48.

[22] See for example the rules on doorstep selling and distance contracting, now laid down in Directive 2011/83/EU on consumer rights [2011] OJ L304/64.

[23] For a critical discussion of this policy, see Geraint Howells, 'The Potential and Limits of Consumer Empowerment by Information' (2005) 32 *Journal of Law and Society* 349.

[24] Directive 2005/29/EC concerning unfair business-to-consumer commercial practices in the internal market (2005) OJ L149/22. Similar rules are laid down in the MiFID, see below part 4.

[25] Consumer Credit Directive, recital 19, Artt. 5(1)(g) and 19.

costs relating to the credit should be specified so that consumers have full information on the cost of the credit agreement.[26] Other information requirements relate to the credit providers contact details and the terms and conditions of the credit agreement, including the timetable for repayment, charges for late payments, and the conditions for early repayment.[27] Information of this kind must also be provided in the credit agreement itself.[28]

Although consumers benefit from greater transparency in the credit market, the policy of consumer empowerment through information duties – or disclosure – has been increasingly criticized. Behavioural studies reveal that the ability of consumers to make rational choices and comparisons is imperfect. It is limited not only by the information that consumers have, but also by the cognitive limitations of the mind and the (often short) time within which decisions have to be made ('bounded rationality').[29] As said, the post-crisis attitude to regulation of the financial market in Europe has also shifted towards stricter control. The law in this area is therefore in a state of flux: on the one hand, responsibilities of creditors and consumers are divided along traditional lines of party autonomy and empowerment through information; on the other hand, there is a push for greater protection of consumers, for example by imposing a duty of 'responsible lending' on credit providers.[30] The Directive for now leans towards the first type of regime, empowerment through information, but may be complemented by more extensive in the private laws of the Member States. I will elaborate on this with reference to solutions adopted in some national laws.

The discussion on responsible lending has gained new prominence also in relation to the proposal for a Directive on mortgage credit. I will refer to this proposal in the discussion of the Consumer Credit Directive and will also say a few words about it separately.

a. Responsible lending and the Consumer Credit Directive[31]

The balance between information provision and 'responsible lending' is not an easy one to strike. Practically, banks and consumers have different stakes in the market, which is reflected in consumer law. Banks are generally willing to be more open as to whom they give credit and on what terms.[32] Consumer groups, on the other side, emphasize the need for consumer protection, e.g. through information and advice requirements, or duties to warn.[33] However, the picture is not as black and white as this. Greater consumer protection can also have negative backlashes for consumers. Should stricter consumer protection measures be adopted, the result can be that credit becomes unavailable to certain – low-income – groups of society. That can be detrimental to the welfare of society, where homeownership counts as a stabilising factor and is

[26] *ibid*., recital 20 and Art. 19(2).
[27] *ibid.*, Art. 5.
[28] *ibid*., Artt. 10 and 11.
[29] Herbert Simon, 'A Behavioral Model of Rational Choice', in: Herbert Simon, *Models of Man: Social and Rational* (Wiley, New York 1957).
[30] On 'responsible lending' in the consumer credit market, see also Vanessa Mak and Jurgen Braspenning, '*Errare humanum est*: Financial Literacy in European Consumer Credit Law' (2012) 35 *Journal of Consumer Policy* 307, 311.
[31] This section contains excerpts from Mak and Braspenning (n 30) 310-311.
[32] European Commission, Proposal for a Directive of the European Parliament and of the Council on credit agreements relating to residential property, COM(2011) 142 final; Council of Mortgage Lenders, UK Industry Briefing on the proposed Directive of the European Parliament and of the Council on Credit Agreements Relating to Residential Property (2011). Available at: http://www.cml.org.uk.
[33] Proposal for a mortgage credit Directive (n 32).

encouraged by governments, often through subsidising or tax benefits. Also, the financial system may benefit from greater availability of credit. Although it can mean that a small number of consumers is worse off for entering into agreements that they cannot afford, greater market participation has been shown to have positive effects on asset pricing and it can have the same effect on the cost of credit and on product innovation by suppliers.[34] From this perspective, access to finance should be promoted by keeping duties of 'responsible lending' limited.

These different viewpoints have come to a clash, most notably in the debate surrounding the review of Directive 87/102 on Consumer Credit in 2002.[35] The outcome, for now, is that the balance has been struck in favour of information provision. The 2008 Directive does not contain a general provision on 'responsible lending', apart from a reference to the general concept in recital 26 preceding the Directive. A general duty to act as a 'responsible lender' was thought to be unacceptably burdensome on banks, in particular since the initial proposal was rather vague on what was included in such a duty.[36] Not surprisingly, therefore, the provisions in the Consumer Credit Directive that specify duties of responsible lending are sparse: in fact, there is only Art. 8 on assessing the creditworthiness of consumers. All other provisions centre on the provision of information to the consumer to enable him to make his own decision on whether 'the credit agreement is adapted to his needs and to his financial situation'.[37]

Notable is also that although Art. 5(6) leaves room for Member States to 'adapt the manner by which and the extent to which … assistance is given', until now Member States have not been inclined to impose stricter advice duties on providers. Not only is this limited duty in line with the idea of the rational, empowered consumer that is central to EU consumer law, it also leads to considerable cost-saving on advice and counselling, and is therefore in the public interest.[38] The tide may be turning, however, with regard to mortgage credit; in the current debate on 'responsible lending' in the mortgage credit market, more emphasis appears to be placed on the need for adequate advice.[39]

At the same time, Article 8, which obliges credit providers to investigate the creditworthiness of consumers, could potentially be used to protect vulnerable consumers. It is problematic that the provision itself does not specify which consequences should be attached to the consumer's lack of creditworthiness. Although the image of a consumer who is able to digest information is not easily matched with a prohibition of concluding a credit contract with such a non-creditworthy consumer,[40] it is defendable that the Directive would allow a warning to the consumer on the basis of recital 26.[41] A more far-reaching solution would be to impose a duty to deny credit on providers in case a consumer does not pass the creditworthiness test.[42] Such a duty is in fact included in Article 14 of the proposal for a Mortgage Credit Directive and would

[34] Moloney (n 7) 77.
[35] Peter Rott, Consumer credit, in: Hans-W. Micklitz, Norbert Reich, Peter Rott and Klaus Tonner, *European Consumer Law* (2nd ed, Intersentia, Antwerp 2014), 197 ff.
[36] *ibid*., 185.
[37] Consumer Credit Directive, Art. 5(6).
[38] Compare Kamerstukken II 2003-2004, 29 507, nr. 3, p. 86.
[39] Financial Services Authority (FSA). (2011). *Mortgage Market Review*, CP11/31, 28-29.
[40] Udo Reifner, 'Konsumentenkreditrichtlinie im Europaparlament – Zurück zu den Siebzigern?', (2004) *Verbraucher und Recht*, 85, 88; Stefan Grundmann and Jörg Hollering, 'EC Financial Services and Contract Law – Developments 2005–2007, (2008) 4 *European Review of Contract Law* 45, 50.
[41] Rott (n 35) 199.
[42] Such a duty exists for example with regard to 'margin requirements' in Dutch investment law; see part 4 below.

require a denial of credit to *any* category of consumer, not just the most vulnerable.[43] Moreover, some national systems already adopt such a protective stance with regard to consumer credit. Dutch and Belgian law – unlike most systems in Europe – stipulate that credit should be denied where the assessment of a consumer's creditworthiness indicates that the proposed credit agreement puts him at risk of over-indebtedness.[44]

It should be noted that even if the Consumer Credit Directive or ancillary regulation in national law does not impose duties of advice, warning or denial of credit on credit providers, such obligations may arise in the general private law of a Member State. In Dutch and German case law duties of care have been recognized to protect consumers with regard to the purchase of complex financial products (e.g. complex credit/investment combinations). The provider, as the expert party, is obliged to take account of the interests of the consumer and to protect him against the risks associated with his lack of insight or his own rash decision-making. More specifically, this means that banks and investment firms are obliged to warn consumers about the specific risks of a product, to investigate the financial position of the client, and if the circumstances demand it even advise the client against purchase of the product.[45]

b. Mortgage credit

Mortgage credit is a special case. It was explicitly excluded from the scope of the Consumer Credit Directive, as seen in Art. 2(2)(a) of the Directive.[46] This exclusion may be explained by the nature of mortgage credit which, unlike simple credit, is not just of a contractual nature but also has implications in property law since the right of mortgage functions as a security for the payback of the credit. For these aspects one necessarily has to fall back on national laws. Further, when pre-crisis the housing markets were doing increasingly well, banks saw little in imposing restrictions – such as an over-indebtedness test – on consumers' ability to obtain credit.[47]

As indicated at the beginning of this chapter, however, the EU legislator has recently adopted a new Directive concerning consumer mortgage credit which aims to lay down minimum rules throughout the EU aimed at establishing a policy of 'responsible lending'.[48] Apart from the provisions dealing with the standardized information provided to consumers through the European Standard Information Sheet (ESIS) and with information regarding the Annual Percentage Rate of Charge (APRC), all of the Directive's provisions aim at minimum harmonization rather than full harmonization.[49] In substance, the Directive for a large part draws on the norms on conduct of business in the Consumer Credit Directive[50] and creates a similar framework for mortgage credit, taking into account the specificities of mortgage credit where

[43] Proposal for a mortgage credit Directive (n 32).
[44] In the Netherlands, such a duty was first introduced in Article 28 Wet consumentenkrediet in 2006; it is now laid down in Article 4:34 Wet op het financieel toezicht (Wft). For Belgium, see Article 15 Wet op het consumentenkrediet (WCK).
[45] Dutch Supreme Court (HR) 5 June 2009, *Nederlandse Jurisprudentie (NJ)* 2012, 182 (*De Treek v. Dexia*). Similar judgments appeared with respect to two other investment firms, Levob and Aegon; see HR 5 June 2009, *NJ* 2012, 183 (*Levob*); HR 5 June 2009, *NJ* 2012, 184 (*Aegon*). For German law, compare *Ille Papier v. Deutsche Bank*, BGH 22.03.2011 XI ZR 33/10, in which the protected party was not even a consumer but a medium-sized business.
[46] See also Consumer Credit Directive, recital 14.
[47] Compare Council of Mortgage Lenders UK (n 32).
[48] Consumer Mortgage Credit Directive (n 1), recital 5.
[49] Mortgage Credit Directive, Art 2.
[50] Consumer Credit Directive.

appropriate.[51] An important feature of the Directive is that it prescribes a strict creditworthiness assessment, which focuses in particular on the ability of the borrower to repay the loan. To that end, the lender should assess (and verify!) the ability of the borrower to repay the loan over his lifetime, taking account in particular of future payment or interest increases. Further, the affordability of the credit 'should be considered in the light of other regular expenditure, debts and other financial commitments as well as income, savings and assets.'[52] The duty to assess the borrower's creditworthiness is combined with a duty to deny credit if the consumer does not fulfil it. Although this is could give a boost to the 'responsible lending' approaches in national legal systems, many Member States have since the financial crisis adapted their laws and do now include such prohibitions – if they did not already, like the Dutch and the Belgian systems.[53]

The Consumer Mortgage Credit Directive should be implemented by the Member States by 21 March 2016. In the meantime, the Consumer Credit Directive has proved to be relevant to mortgage credit. The decision of the Court of Justice of the EU in *Volksbank Romania* confirms that it is possible for Member States to voluntarily adopt national legislation that extends the provisions of the Directive to consumer mortgage agreements.[54] In that case the extension of the rules meant that consumers were effectively protected against the levying of a 'risk charge' as part of their mortgage credit agreement. Whether the extension of the Directive's rules to mortgage credit should be allowed in the light of the Directive's full harmonization character, in particular since mortgage credit is explicitly excluded from its scope, is a point of contention.[55]

4. Investment

Consumer investment services are governed by the MiFID, the UCITS Directive and the Prospectus Directive.[56] These instruments regulate the access to markets for providers of investment services – as seen above, through a 'passport regime' – and the protection of the retail investor. Interestingly, the Directives until now have focused on access and on protection through information but have otherwise not interfered with the quality of financial products. Unlike other products, which are often subject to product quality requirements, financial products can therefore be brought into circulation without a quality assessment. It is up to the consumer, with the relevant information from the provider, to determine what the characteristics of a product are and whether it would be wise to enter into an investment agreement or not.[57] That paradigm, as will be seen, is however under pressure as stricter intervention is proposed in response to the economic crisis.

a. MiFID

The MiFID consists of a framework Directive (Directive 2004/39/EC), accompanied by an implementing Directive (Directive 2006/73/EC) and an implementing Regulation

[51] Proposal for a Directive on credit agreements relating to residential property, COM(2011) 142, 4.
[52] Mortgage Credit Directive, recital 55.
[53] See n 44.
[54] CJEU, Case C-602/10 *Volksbank Romania* [2012] ECR 0000.
[55] See below, part 5.
[56] Directive 2003/71 on the prospectus to be published when securities are offered to the public or admitted to trading [2003] OJ L345/64.
[57] See Micklitz cs (n 2) 396.

(Regulation No 1287/2006) which specify more detailed rules on organisational requirements and procedures for investment firms as well as transparency requirements.[58] The regime laid down in these instruments is based on information requirements. To an extent, however, the regime goes beyond the information paradigm and imposes a stronger duty on investment firms to safeguard the interests of their clients. That is exemplified for example in so-called 'conduct of business obligations' laid down in Article 19 of the MiFID.

In the application of the MiFID it is important to realize that the level and manner of protection varies depending on the type of client and the type of transaction. I will briefly discuss the rules for individual advice and portfolio management and for non-advised relationships, including 'execution only' transactions. First, a few introductory comments on the general MiFID framework.

(i) The MiFID regime in general

With regard to the substantive protection that the MiFID aims to provide to investors it is noticeable that the MiFID Directive not only imposes information requirements but also a more general duty of care. This duty, laid down in Article 19(1) of the Directive, entails that an investment provider acts 'honestly, fairly and professionally' in accordance with the best interests of its clients and that it complies with the 'principles' set out in the remainder of Article 19. Specifications in Article 19(3) and (5) clarify that the provider is in certain circumstances obliged to give certain risk warnings or to warn if they find the product unsuitable for their client.

The importance of these obligations, however, should not be overstated. Although they indicate a greater commitment to the client's interests, the final responsibility for the investment decision always lies with the client. Even in cases where the investment provider is required to test the suitability or appropriateness of a product, its subsequent actions need only take the form of recommendations or warnings. There is no duty to protect a client by, for example, denying him the investment contract.[59] A second point is that the general duty of care is very broad. This makes it hard to monitor its compliance through public law or supervision. In private law it may give rise to liability in contract or tort, but here the problem is that the MiFID does not extend into these areas of the law so that liability needs to be established in accordance with the rules of private law of each Member State.[60]

MiFID protection nevertheless offers considerable protection to retail consumers. That protection, moreover, goes much further than the protection of professional clients. The conduct of business obligations are meant to be applied more strictly in consumer cases; professional clients are deemed to have sufficient knowledge and experience to navigate the investment market by themselves and are therefore subject to a lighter regime.[61]

(ii) The 'know your customer' rules

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[58] MiFID (n 19); Directive 2006/73/EC implementing Directive 2004/39/EC as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive [2006] OJ L241/26; Regulation No 1287/2006 implementing Directive 2004/39/EC as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive [2006] OJ L241/1.
[59] MiFID, Art 19(4) and (5).
[60] See in more detail under 4.a.*(ii)*.
[61] Cf. MiFID, Art 4(1) sub 11 and 12, and Annex II; MiFID Implementing Directive, Artt 35 and 36.

The characteristic protective obligations of the MiFID, which are mostly relevant for retail investors,[62] are the 'know your customer' rules laid down in Article 19(4) and (5). The Directive establishes two regimes. In cases where individual advice or portfolio management is provided, investment firms are obliged to assess the suitability of the product for their client, taking into account the client's knowledge and experience in the field, his financial position and his investment objectives. For other services a lighter regime applies. Firms are obliged to assess the appropriateness of the product for their client based on the clients knowledge and experience in the investment field relevant to the desired product.[63]

The 'know your customer' tests do not have to be applied to certain 'execution only' transactions. 'Execution only' refers to the execution and/or the reception and transmission of client orders. Such services are exempted if they fulfil the following criteria: (i) they involve non-complex financial instruments (such as shares and simple bonds); (ii) the services are provided at the initiative of the client; and (iii) the client should be informed that no 'know your customer' obligations apply.[64]

Besides the MiFID 'know your customer' rules, a minimum level of security for retail investors is guaranteed through margin requirements. A margin requirement – e.g. stipulated in the regulations of the European Options Exchange (EOE) – is the minimum amount in the form of cash or eligible securities that an investor must deposit in a margin account before buying or selling positions in options.[65]

Compliance with the MiFID investor protection rules is monitored through public law supervision.[66] Besides this, individual clients – retail investors – may be able to claim compensation under national private law if the non-compliance with these rules has caused them detriment. Many Member States enable this but how the action should be pursued depends on national rules of tort law. Some Member States have recognized quite broad duties of care for investment services to consumers. Dutch and German courts, for example, have elaborated duties of care on the basis of the investment firm's expertise. These duties – which in later case law have also been recognized for other complex financial products – put the responsibility for investment decisions for a large part with the investment firm. In some situations this has resulted in liability of the (bank) investment provider even where warnings had been given but the client stubbornly insisted on entering into the investment agreement despite not having fulfilled the margin requirements.[67] The liability in damages of the investment firm, however, can be limited on the ground of contributory negligence by the retail investor.[68] Under English law, non-compliance with the conduct-of-business rules can give rise to liability under s.138D of the Financial Services Act 2012 (formerly s.71 of

[62] For professional clients it may be assumed that they have the necessary knowledge and experience in order to understand the risks involved in a particular investment, MiFID Implementing Directive, Art 36. Moreover, with regard to the suitability test in case of advice relationships or portfolio management, such knowledge may also be assumed and it may be assumed that the professional client is able to financially bear the risks of the investment, MiFID Implementing Directive, Art 35(2).
[63] MiFID, Art 19(4) and (5).
[64] Cf. MiFID, Art 19(6).
[65] See also Olha Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights' (2010) 33 *Journal of Consumer Policy* 403, 416.
[66] MiFID Implementing Directive, Art 6.
[67] Dutch Supreme Court (HR) 11 July 2003, *NJ* 2005, 103 (*Kouwenberg/Rabobank*).
[68] Cherednychenko (n 65) 416. A similar limitation has been applied in the *Dexia* case law (n 45).

the Financial Services and Markets Act 2000). This action is subject to the defences and other incidents applicable to breach of a statutory duty (e.g. contributory negligence).[69]

(iii) Review of the MiFID

The MiFID has just gone through a substantive review, culminating in the adoption of a new MiFID Directive (MiFID II) and a MiFID Regulation (MiFIR).[70] Whereas substantive protection through 'know your customer' rules will be continued, the new rules also introduce product intervention possibilities for designated authorities. Competent authorities in the Member States may – after consulting the European Securities and Market Authority (ESMA) – prohibit or restrict the marketing, distribution or sale of certain financial instruments or structured deposits or financial instruments or structured deposits with certain specified features.[71] This competence arises when 'a financial instrument, structured deposit or activity or practice gives rise to significant investor protection concerns or poses a threat to the orderly functioning and integrity of financial markets or commodity markets or to the stability of whole or part of the financial system within at least one Member State', or 'a derivative has a detrimental effect on the price formation mechanism in the underlying market'.[72] Further requirements are that existing EU regulation does not sufficiently address the stated risks and that the issue would not be better addressed by improved supervision or enforcement of existing requirements. Also, the action must be proportionate, it has to be consulted with authorities in other Member States which may be significantly affected by it, and it must not be discriminatory.[73] In addition to this regime, ESMA itself will have the competence to temporarily prohibit or restrict products, practices or services that gives rise to investor concerns or threatens the integrity of the financial markets.[74]

Under this regime, set to enter into force in the course of 2017,[75] the quality of financial products will be directly subject to regulation. This change of policy comes in the wake of a whole range of regulatory measures adopted at EU level in the aftermath of the financial crisis. Whether stricter regulation is the way forward is open to question. I will come back to this point in part 6.

b. UCITS

The MiFID's 'execution only' regime, which as explained imposes a lighter regime on investment firms, has been extended to so-called UCITS products. UCITS are undertakings relating to collective investments through investment funds. They enable retail investors to diversify their portfolio by acquiring units of various investments in the fund. For these types of funds, EU law again emphasizes information requirements as the main means of consumer protection.[76] Two observations can however be made with regard to the effectiveness of this type of protection.

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[69] See Danny Busch, 'Why MiFID Matters to Private Law—The Example of MiFID's Impact on an Asset Manager's Civil Liability' (2012) 7 *Capital Markets Law Journal* 386.
[70] Directive 2014/65/EU on markets in financial instruments [2014] OJ L173/349; Regulation 600/2014 on markets in financial instruments [2014] OJ L173/84.
[71] MiFIR, Art 42.
[72] MiFIR, Art 42(2)(a).
[73] MiFIR, Art 42(b)-(e).
[74] MiFIR, Art 40.
[75] MiFID, Art 93; MiFIR, Art 55.
[76] UCITS Directive, Artt 69 and 78.

First, the Directive requires investment companies to provide retail investors with a prospectus relating to the funds it manages. Realizing that consumers may not be able to process the information provided – e.g. because of 'bounded rationality – the Directive now also requires that investors are provided with 'key investor information' in a short document.[77] Although this type of simplified information provision goes some way towards assisting retail investors in their decision-making, at least by preventing an information overload, it may create other problems. One may wonder, for example, whether it is sufficient for a retail investor to rely on the key investment information when deciding to enter into an investment agreement or whether it is still necessary to consult the entire prospectus.[78]

Second, some of the products falling within the definition of UCITS have become quite complex and sometimes even resemble hedge-fund like structures. These type of products are generally difficult to understand for consumers and the extension of the MiFID's 'execution only' regime to all UCITS without distinction has been criticized from a viewpoint of consumer protection.[79] The UCITS regime has also been reviewed and it appears that criticisms with regard to UCITS transactions falling within the MiFID's 'execution only' regime have been taken to heart. MiFID II proposes to exclude from this regime products that 'embed a derivative or incorporate a structure which makes it difficult for the client to understand the risk involved'.[80] This change is good for consumer protection and it is welcomed by a number of policy makers.[81] Still, it should not be taken for granted that these changes made it into the final legislation. UCITS are commonly regarded as a 'gold standard' product – i.e. very reliable – and any restriction on their marketing is likely to be met by strong opposition from big market players.[82]

5. Full harmonization and private law

EU legislation on financial services is backed up by rules of contract and of tort law which in the majority of cases are rules of national origin; only some rules – such as on distance contracts – are laid down by EU legislation.[83] Whether national laws can be maintained besides Directives aimed at full harmonization, such as the Consumer Credit Directive and the MiFID, is a point of contention.

No clear picture emerges from current law. Whereas most national laws seem to concede that lesser duties than those laid down in the MiFID regime are unacceptable, with regard to stricter duties national laws are more diverse. Civil courts in England and Wales, Scotland, Italy, Spain and Ireland appear to be able to subject investment firms to stricter duties. France and Luxembourg allow less room for this, whereas the situation in the Netherlands and Germany is undecided.[84] Although the courts have indicated that private law duties do not have to coincide with public law requirements, the judgments stating this precede the MiFID and therefore do not directly comment on whether it would be possible (or even desirable) to impose stricter duties than the protection offered through the MiFID's conduct of business

[77] UCITS Directive, Art 78.
[78] Micklitz cs (n 2) 409.
[79] See Moloney (n 3) 192.
[80] MiFID II Art 25(4)(a)(iii).
[81] Moloney (n 3) refers to reports from the French supervisor AFM, the European Securities Committee and consumer organization BEUC; see p 192.
[82] Moloney (n 3) 193.
[83] Directive 2002/65/EC concerning the distance marketing of consumer financial services [2002] OJ L271/16.
[84] Busch (n 69).

regime. Some authors hold the view that this regime is on its own sufficiently strong to ensure investor protection.[85] Looking at the way in which the concept of full (or maximum) harmonization has developed in EU law, arguably stricter protection through national private law is possible since the MiFID is concerned only with regulatory law.[86] Similarly, it would seem possible to adopt stricter rules in the consumer credit field if such rules are based on different legal ground or if they are outside the scope of the Directive.[87] Nevertheless, the last word has not been said about the meaning of the term 'full harmonization' and the exact balancing between national and EU rules, especially when they extend across private law and administrative law, will require further research.

6. Market regulation after the crisis

As said in the introduction of this chapter, EU law in the financial services area is under pressure from various angles. In the aftermath of the financial crisis the EU legislator seems to have shifted from a liberal market approach to a stricter regime of regulation of the supply-side of the market, which has consequences for access rules and also for the substance of consumer protection rules. Further, with regard to its substantive approaches to consumer protection the policy of regulating protection through information requirements for traders has been second-guessed on the basis of insights from behavioural psychology. The regulatory framework for consumer financial services will continue to be influenced by such developments in the near future. This raises questions of methodology, e.g. how can the insights from behavioural studies be translated into actual regulation.[88] Moreover, it poses the question whether new regulation should be adopted as a response to the crisis. Although it seems an understandable move for the short-term, a more critical approach for the longer term would seem advisable.

It is clear that the crisis has had a severe impact on the approach to regulation adopted by legislatures worldwide. The crisis is for a large part blamed on excesses, or a lack of self-correcting mechanisms, in a market economy. With regulation, legislatures seem to want to put that right. In the aftermath of the crisis, the European legislature has adopted an impressive range of regulatory measures. Some have referred to this process as 'death by a thousand Directives', which is mirrored however by similar developments in other part of the world: in the US for example, by the 2-kilo Dodd-Frank Act.[89] Important proposals in Europe concern the product intervention rules suggested in the review of the MiFID, discussed in part 4.

Whether this is the right course to take in the long term is a difficult question. Even economists, who on the basis of their expertise have a better understanding of markets and long term planning than most lawyers, cannot agree on a coherent story as to what works and in which circumstances. Nevertheless, some estimation can be made

[85] Busch (n 69).
[86] See Vanessa Mak, 'Review of the Consumer Acquis – Towards Maximum Harmonisation?' (2009) 17 *European Review of Private Law* 55; Olha Cherednychenko, 'Full Harmonisation of Retail Financial Services Contract Law in Europe: A Success or a Failure?', in: Stefan Grundmann and Yeşim Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law. Failure and Challenges of Contracting* (Kluwer Law International, Alphen aan den Rijn 2011), 221-58.
[87] The latter could be argued for the provisions in Dutch and Belgian law which seek to prevent over-indebtedness; see n 44 above.
[88] See Mak and Braspenning (n 30) 321 ff.
[89] Clifford Chance, 'Sea of Change. Regulatory reforms to 2012 and beyond' (Briefing note, November 2010). Available at: http://www.cliffordchance.com/content/dam/cliffordchance/PDFs/SOC_Open_Boat_LR.pdf.

if we look at regulation scholarship. Studies of regulatory innovation show that the effects of regulation are often modest and do not per se result in a change of behaviour of the actors subject to the regulation.

Regulatory innovation refers to changes that can be made through regulation. At its most effective, the process results in transformative regulation, which means that new rules have a lasting effect on the behaviour and practices of those for whom the regulation is written.[90] This is however only the third and final stage of a process. Two stages can be discerned which introduce more subtle changes in the regulatory framework. At the first level, changes are made only to the setting of regulation. Technical changes may be made to rules and practices which, although they may have innovative effects, do not change the regulatory status quo and are not perceived as innovation. Changes at the second level relate to the institutional setting and the nature of regulation. Examples would be a change from soft law to hard law, or a change of the regulatory institution (e.g. the merger of supervisory authorities).[91] Such changes are often accompanied by transformative regulation. This third stage, transformative regulation, is the most far-reaching as it directly relates to the cognitive and normative nature of regulation. It can lead for example to a resetting of policy goals of regulation, and can have extensive effects on the nature of regulation and related transformative effects.[92]

Looking at the current reforms in financial services law, and in particular the review of the MiFID, two observations can be made. First, by expounding more regulation the impression can be created that consumers in the financial services market are protected against all risks. It would be wrong, however, to create such a 'zero failure' image. Supervisory authorities, even if they have greater powers, will not be able to guarantee that the products that they allow onto the market are always safe.[93] The ensuing possibility that supervisory authorities can be held liable for any failure to intervene, moreover, must be regarded as undesirable.

Second, one may wonder whether the new regulation addresses the relevant problems in the market. Although risky products have caused problems in the past – as seen e.g. in the *Dexia* litigation in the Netherlands – the strengthened framework of protection in financial services law that has developed since then, for example through the MiFID and through private law duties of care, may provide sufficient cover for retail investors.[94] One should not forget that consumers also have an own responsibility to take care when venturing into risky markets. The real question may be whether the existing rules are sufficiently attuned to the way in which consumers actually make decisions. Are they able to assess the risks of a product and what elements – knowledge and experience of the relevant market, financial literacy, financial position – should be taken into account by regulation seeking to protect consumers in that decision-making

[90] For a description, see Julia Black, 'What is Regulatory Innovation?', in: Julia Black, Martin Lodge, Mark Thatcher, *Regulatory Innovation: A Comparative Analysis* (Edward Elgar Publishing, Cheltenham 2005) 1, 9-10.
[91] Such as recently in the Netherlands the creation of a new Authority Consumer and Market, which combines the activities that were previously carried out by the Consumer Authority and the Dutch Competition Authority.
[92] Black (n 90).
[93] Cf Financial Conduct Authority (FCA), *Approach to Regulation* (juni 2011), available at http://www.fsa.gov.uk/pubs/events/fca_approach.pdf, p 21; HM Treasury, *A New Approach to Financial Regulation: Building a Stronger System* (februari 2011), available at http://www.hm-treasury.gov.uk/d/consult_newfinancial_regulation170211.pdf, p 69.
[94] See Busch (n 69).

process? *More* regulation does not necessarily provide the solution, but perhaps regulation of a different *form* can.[95]

Scanning the field, consumer financial services law in the EU is primarily focused on enabling consumers to access the market and to do so with a fair level of minimum protection. One may argue with the way in which this protection is regulated through law. The information model seems paramount until now, with stricter duties imposed only in the investment rules of the MiFID. Since the economic crisis a shift towards more regulatory protection can be observed. At its strongest, new regulation enables direct product intervention by supervisory authorities at EU level (ESMA) and in the Member States. That, however, may be a step to far, bearing in mind the autonomy of contracting parties, including consumers. In the future, the pendulum may well swing back to a more moderate position.

[95] For a detailed discussion, see Mak and Braspenning (n 30).