Financial Supervision and Consumer Protection in the Post-Crisis European Union: An Uneasy Relationship[1]

1. Introduction

At first sight it may seem odd to juxtapose public supervision of financial markets and financial consumer protection, as the title of this contribution suggests. Indeed, it can be argued that strong financial watchdogs are crucial for ensuring consumer protection in retail financial markets given information asymmetry between financial institutions and consumers and the weaknesses of private enforcement mechanisms. A high level of consumer protection in turn is essential for ensuring public trust in financial markets without which such markets cannot properly function.

While it is certainly true that financial supervision and consumer protection are closely intertwined, as Udo Reifner convincingly showed in his 2012 publication, the reality is much more nuanced that that. Financial supervision does not necessarily serve consumer interests. What is more, financial consumer protection concerns can be trumped by prudential supervisory concerns about keeping bad banks alive.

Now more than a decade after the outbreak of the global financial crisis and five years after the publication of Udo Reifner's thought-provocative analysis, many questions still exist concerning the relationship between financial supervision and consumer protection in the EU multi-level system of governance post-crisis. The current reform of European supervisory authorities – European Banking Authority (EBA), European Securities and Markets Authority (ESMA), and European Insurance and Occupational Pensions Authority (EIOPA) – provides an opportunity to revisit the role of financial consumer protection within the European system of financial supervision.[2] In the following, I will share some of my thoughts on this topic inspired by Udo Reifner's work.

2. The vulnerable position of consumer protection within the EU regulatory framework for financial markets.

While the need for a high level of financial consumer protection has been increasingly acknowledged at the EU level, consumer interests do not appear to be a central concern of EU financial regulation. In the EU context, consumer protection – alongside other specific objectives of financial regulation such as market efficiency and financial stability – are linked to the promotion of the single market as a meta-goal. Protective measures are primarily justified by the considerations of ensuring access of financial consumers to the internal market.[3] Unlike traditional national private laws, therefore, EU financial regulation regards private parties not as ends in themselves, but rather as market functionaries, such as consumers, retail investors, investment firms or mortgage credit intermediaries, who are

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[1] Comment on U. Reifner, 'Financial Services and Consumer Protection – From Private Law to Bank Supervision', E. Buttigieg (ed.), Rights and Remedies for the Consumer in the European Union, (Gutenberg Press: Malta, 2012), pp. 99-124.

[2] Communication from the Commission to the European Parliament, the Council, the European Central Bank, the European Economic and Social Committee and the Committee of the Regions, *Reinforcing Integrated Supervision to Strengthen Capital Markets Union and Financial Integration in a Changing Environment*, COM(2017) 542 final.

[3] Cf. H.-W. Micklitz, 'Introduction – Social Justice and Access Justice in Private Law, in H.-W. Micklitz (ed.), *The Many Concepts of Social Justice in European Private Law*, (Edward Elgar: Cheltenham and Northampton, 2011), p. 3.

supposed to play their roles in the internal market. Transactions between financial institutions and consumers are thus seen as vehicles of financial market integration.

The vulnerable position of consumer interests within the EU regulatory framework for financial markets manifests itself in contradictions and tensions between the post-crisis policies and regulatory objectives, demonstrating a lack of a coherent agenda for retail financial markets. Thus, for example, in the post-crisis period the EU has tightened its regulatory grip on traditional sources of finance with a view to ensuring financial stability and a high level of consumer/retail investor protection. At the same time, it has also adopted a facilitative approach to crowdfunding – an alternative form of financing emerging from outside the conventional financial system that connects those who give, lend or invest money directly with those who need financing – with a view to promoting easier access to finance for European consumers and SMEs and supporting market growth.[4] While crowdfunding generates profound consumer protection concerns,[5] these concerns appear to be of only secondary importance in the context of the EU efforts to promote this novel form of fundraising as part of its economic growth agenda.[6] Even though the European Commission is currently exploring whether the EU should take action in this field, as the Commission itself has noted, '[t]he overall aim of this initiative is to enable crowdfunding activity to grow by making better use of the Single Market potential.'[7]

The weak position of consumer interests in the current EU regulatory landscape also comes to light in the context of the post-crisis financial stability agenda. For example, in response to the stricter capital adequacy rules (Basel III as transposed at the EU level in CRD IV and CRR),[8] many European banks have issued so-called contingent convertible securities, commonly known as CoCos. While these innovative instruments have been welcomed by financial regulators from the point of view of financial stability, they have raised major retail investor protection concerns.[9] It is questionable, however, whether ESMA and other two ESAs are well-equipped to address such concerns given the integrated model of financial supervision (prudential and conduct of business supervision under one roof) that underpins them, as well as the subsidiary position of retail market governance to stability-oriented governance in the EU regulatory landscape. Notably, according to the 2014 European Commission's report on the operation of the ESAs, the general view among stakeholders was that consumer protection had not been given sufficient priority in the work of the ESAs.[10] It remains to be seen whether

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[4] Eg European Commission, Communication on Long Term Financing of the European Economy (COM(2014) 168 final) and European Commission, Communication on Unleashing the Potential of Crowdfunding in the EU (COM(2014) 172 final).

[5] See eg G. Ferrarini & E. Macchiavello, 'Investment-Based Crowdfunding: Is MiFID II Enough?', in D. Busch & G. Ferrarini (eds), *Regulation of the EU Financial Markets: MiFID II and MiFIR* (Oxford: Oxford University Press, 2017) 659, 690.

[6] Cf. N. Moloney, 'Regulating the Retail Markets', in N. Moloney *et al.* (eds), *The Oxford Handbook of Financial Regulation* (Oxford: Oxford University Press, 2015) 736, 744.

[7] European Commission, Legislative Proposal for an EU Framework on Crowd and Peer to Peer Finance: Inception Impact Assessment, Ref. Ares(2017)5288649 - 30/10/2017, 2.

[8] Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC, *OJEU* 2013 L 176/338 (CRD IV) and Regulation (EU) No 575/2013 of the European Parliament and of the Council of 26 June 2013 on prudential requirements for credit institutions and investment firms and amending Regulation (EU) No 648/2012, *OJEU* 2013 L 176/1 (CRR, respectively.

[9] See eg ESMA, *Potential Risks Associated with Investing in Contingent Convertible Securities: Statement,* ESMA/2014/944.

[10] Report from the Commission to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), SWD(2014) 261 final, 14.

the current reform of the European system of financial supervision, which does not envisage a clear separation between prudential supervision and conduct of business supervision, will bring about a major improvement in terms of financial consumer protection.

3. Towards European supervision private law: What about remedies for individual consumers?

In addition, an uneasy relationship between financial supervision and consumer protection manifests itself in the lack of a coherent and effective enforcement strategy in the area of European financial law, particularly when it comes to private enforcement. It is notable that the rise of public supervision over private relationships between financial institutions and consumers has led to the development of what, in my view, could be called 'European supervision private law'.[11] I use this oxymoron to describe any body of regulatory conduct of business rules of EU origin, to be observed by businesses when dealing with their (potential) clients, which forms part of a framework for public supervision over a specified market and is subject to public enforcement. From a legal-technical point of view, European supervision private law rules in the above-mentioned sense concern the relationship between a particular business and an administrative agency entrusted with the supervisory and enforcement tasks and, hence, they do not belong to the realm of traditional private law, in particular contract law. At the same time, such rules set standards of behaviour in the relationship between a business and its (potential) client and also aim to protect the latter. In essence, therefore, European supervision private law rules affect the relationships between private parties and can thus be considered as quasi-private. In general terms, this emerging legal field is characterized by a *regulatory* focus, predominantly *ex ante* norm-setting, particularly by supervisory authorities, developing *outside* national *private law* systems and being enforced by *public* bodies through *administrative* law means. European supervision private law in this sense can be found, for example, in the MiFID[12] and MiFID II[13] conduct of business rules, such as the general duty of investment firms to act in the client's best interests or the know your client principle.

The inclusion of financial consumer protection standards within the framework for financial supervision allows financial regulators to supervise financial institutions' compliance with such standards and, if necessary, enforce them through administrative law means. At the same time, it also raises major questions concerning the private enforcement of financial consumer protection standards by individual consumers or their groups.[14] The MiFID case is probably most instructive in this context. Being based on the public supervision and enforcement model, this EU investor protection measure did not provide any clear guidelines concerning the enforcement of the contract-related conduct of business rules contained therein by the aggrieved investors or their groups by means of national private laws. Member States, therefore, had a wide discretion as to how to deal with this issue.

Given that the MiFID conduct of business rules were cast as standards of financial supervision in the EU and national legislation, it does not come as a surprise that major

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[11] On this emerging legal field in more detail, see O.O. Cherednychenko, 'Public Supervision over Private Relationships: Towards European Supervision Private Law?', 22 *European Review of Private Law* 2014, 37.

[12] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, *OJEU* 2004 L 145/1 (MiFID).

[13] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (MiFID II).

[14] On this in more detail, see O.O. Cherednychenko, 'Public and Private Enforcement of European Private Law in the Financial Services Sector', 23 *European Review of Private Law* 2015, 621.

differences have emerged between Member States concerning the effect of such rules as between the investment firm and its (potential) client in national private laws. While in some Member States, such as the Netherlands, civil courts do consider the MiFID conduct of business rules when determining the private law standard of care or loyalty in individual cases, in others they do not have any impact on the normative content of the traditional private law norms. The latter path is followed, for example, by the civil courts in Luxembourg where contract-related regulatory duties included in the financial supervision legislation are not seen as technical explanations of private law duties and where the violation of such rules has no impact on the investment service providers' liability in private law.[15]

A similar approach has also been adopted by the Scottish judge in *Grant Estates Ltd.* v. *Royal Bank of Scotland*[16] concerning the alleged mis-selling of interest rate swaps to a small property developer. In the view of Lord Hodge, the property developer could not rely on the MiFID conduct of business rules to bring into existence a common law duty of care in relation to the provision of investment advice by the bank.[17] In the light of the MiFID system of client classification, however, one may question to what extent Lord Hodge was right in rejecting the existence of the bank's common law duty of care towards a small property developer in this case. If the MiFID client classification was applied, the property developer would fall under the broad concept of 'retail investor' which covers not only natural persons but also small- and medium-sized companies; hence, it would enjoy the highest level of regulatory protection based on a determination that this company's knowledge, expertise, and experience in relation to interest rate swaps is similar to that of a consumer. Nonetheless, the fact that the MiFID conduct of business regime was primarily addressed to financial supervisory authorities was used by Lord Hodge as an argument against granting effect to the MiFID investor protection regime in common law.

It is also notable in this context that in its preliminary ruling on the interpretation of the MiFID in *Genil* v. *Bankinter*,[18] the Court of Justice of the European Union (CJEU) has not taken the opportunity to clarify its view on the issue of the relationship between the MiFID conduct of business rules and traditional private law duties of care and loyalty. Such an opportunity was provided by the question of the Spanish court concerning the contractual consequences of the investment firm's failure to carry out the 'appropriateness' and 'suitability' tests required under Articles 19(4) and 19(5) of the MiFID. In particular, the Spanish court wanted to know whether the violation of these provisions of the MiFID should result in the nullity of the contract between the investment firm and the investor. When answering this question, the CJEU merely stated that, in the absence of EU legislation on this point, it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with the MiFID conduct of business rules, subject to observance of the principles of equivalence and effectiveness.[19] This reasoning of the CJEU, however, does not make it unequivocally clear that the conduct of business rules laid down in the MiFID should have effect in national private laws, albeit this might be the most plausible interpretation of the Court's dictum.

Such a restrictive answer by the CJEU could in part be explained by a somewhat narrow formulation of the national court's question. Yet it may also be a sign of the European

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[15] I. Riassetto and J.-F. Richard, 'Luxembourg', in D. Busch & D.A. DeMott (eds), *Liability of Asset Mangers* (Oxford: Oxford University Press, 2012), s. 6.62.
[16] Court of Session 21 August 2012 [2012] CSOH 133 (*Grant Estates Ltd. (in liquidation) and others* v. *Royal Bank of Scotland plc and others*), see www.scotcourts.gov.uk/opinions/2012CSOH133.html.
[17] *Ibid*., in particular at [71].
[18] Case C-604/11, *Genil* v. *Bankinter*, ECLI:EU:C:2013:344.
[19] *Genil* v. *Bankinter,* paras 57-58.

Court's reluctance to adopt a uniform approach towards such a sensitive issue as the relationship between contract-related investor protection regulation and traditional contract law given a clear emphasis on public supervision and enforcement in the MiFID. This shows that the legal grammar used in the EU directives, in general, and the MifiD's successor – MiFID II – which also closely reflects the public supervision and enforcement model, in particular, may restrict the possibilities for financial consumers to invoke the protective rules contained therein before the Member States' civil courts.

4. Concluding remarks

In the light of the foregoing, together with Udo Reifner I strongly doubt whether consumer interests are taken seriously in the EU regulatory landscape for financial markets. I also cannot but agree with his conclusion that 'consumer protection should be about consumer problems'.[20] This simple but often forgotten truth should, in my in view, inform the development of a coherent EU agenda for retail financial markets with respect to standard-setting, compliance and enforcement. In his 2012 publication, Udo Reifner advocated the creation of independent financial consumer protection agencies at the Member State level. Perhaps the time is now ripe for the establishment of an independent European Financial Consumer Protection Agency within the European financial supervision framework. Further research building on Udo Reifner's pioneering work is much needed to shed more light on this fascinating, yet still largely unexplored, topic.

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[20] Reifner 2012, 112.