



## FINANCIAL SERVICES AND CONSUMER PROTECTION – FROM PRIVATE LAW TO BANK SUPERVISION\*

*Udo Reifner*

### 1. Why do 'financial services' need consumer protection?

The notion of 'financial services' represents a modern approach to services related to the transfer of money across time and space. Historically, the language of credit, savings and insurance was used. All these activities, however, have two elements in common, namely the acquisition of 'money' ('finance') at a certain time (present in credit, future in savings and investment), and the fact that they all provide transportation of this money as a 'service'. But since these services are offered by institutions with either a long (banks and insurance companies) or a relatively recent history (investment companies and payment service providers), the fourfold system of financial services is in practice divided in a traditional two-peak system of banks and insurance companies which cross these functional borders.

**Table 1: Financial Institutions and Financial Services**

	<b>Banks</b>	<b>Investment Companies</b>	<b>Credit Card Companies</b>	<b>Insurance Companies</b>
<b>Savings/ Investment</b>	Savings book/Com. Papers etc.	Commercial Papers		Capital Life and Pensions
<b>Credit</b>	Consumer credit	Money lenders/payday loans	Credit card credit	
<b>Payment services</b>	Bank Account	e.g. Merrill Lynch	American Express	
<b>Insurance</b>	Futures, Options			Risk insurance

This definition of financial services underlies article 2(b) Directive 2002/65/EC on the Distant Marketing of Financial Services, where financial services are defined as 'any service of a banking, credit, insurance, personal pension, investment or payment nature'.

\* This chapter is based on a project for the European Consumer Associations with regard to the forthcoming G20 summit. The final report (Reifner, Clerc-Renaud, Knobloch, 'Financial Supervision in the EU - A Consumer Perspective' February 2011) is available as an electronic resource at <<http://www.responsible-credit.net/media.php?t=media&f=file&id=4237>>.

It is much broader than the definitions in supervisory legislation, and in particular the Banking, Insurance and Investment Directive, which targets banks, insurance and investment or credit card companies if their involvement in financial services goes beyond a certain level. Already this exclusion of smaller entities in itself reveals that because it is not decisive for the consumer whether the product is acquired from a bank or a moneylender, the driving force between bank supervision is not consumer protection but the protection of the money system in general, for which banks and insurance companies are of supreme importance.

For example, the Banking Supervisory Directive 2006/48/EC defines the scope of banking supervision by defining banks as 'credit institutions' and 'electronic money institutions' (article 4(1)) and puts other 'financial institutions' (article 4(5)) under less intensive financial supervision. Directive 2006/49/EC adds 'investment firms' to those subject to this 'light' form of supervision (article 3(1)(b)). The core element of supervision is the requirement that the institution be permitted to carry out the financial activities enumerated in the Directive (article 6 Directive 2006/48/EC).

This institutional approach to financial supervision is confronted with a functional approach to consumer protection.

Consumers need to be protected with regard to all forms of financial services offered in the private marketplace. It is thus broader than the supervisory approach, in which the only financial services subject to supervision are those within a specific group of 'institutions'. This has a significant impact on the ability to promote consumer protection.

The Banking Directives as well as national supervisory law seek to protect banks and insurance institutions, and their safety and soundness for society as a whole. In second place they aim to protect banks and insurance companies as important professions in a society which operates on the basis of the exercise of certain skills and the application of ethical commitments. This area is covered by the 'conduct of business' and 'fair competition' rules in marketing and 'commercialisation'.

Consumer protection requires instead a focus on financial services as a system, with the effect where those services are distributed, but especially where they directly affect the lives of consumers. Consumer protection therefore differentiates neither by institution nor by product. In consumer protection the different categories and social functions of retail financial services require a different level of protection according to the importance of the consumer needs and interests affected. For example, investment services have been seen as more risky than savings, pension schemes have desirable social effects while shareholding is seen as less critical, consumer credit has different implications from mortgage loans or payment services, insurance contracts vary in regulation as to whether they concern vital interests such as health, old age or car accidents, while risk insurance



information rights are seen collectively as sufficient to guarantee the adequacy of the offer.<sup>1</sup>

In the discussion of bank supervisory reform, the special nature of financial services is often based on the assumption that financial services are so complex that special institutions and supervision are required. This argument can often be turned around whereby an existing offer, although not adequate to help people substantively, is presented as a solution by redefining the problem in its own terms. A psychologist being asked for help with aches may thus argue that the person's physical pain seems to be only an imaginary one, thereby making his services adequate, although they may not be so in substance. Because consumer information and advice is part of what can be offered, the problems of consumers must to be defined in terms of asymmetric information. Without any empirical evidence, this becomes a self-fulfilling prophecy in which a sociological insight becomes true. Thus, any existing institution offering a certain form of solutions creates certain problems defined by its potential clients,<sup>2</sup> or at least politicians who want to achieve such definitions for the problems of the target group.

From a consumer perspective, it is arguable that financial products are not complex at all. Because a consumer either receives or pays money at a certain time ('cash flow'), the basic structure of all products is easy to understand. This is also very easy to evaluate, since the APRC can be based ex post facto on the cash flow the financial product has created up to a certain time.

The problem of financial products lies in the uncertainty of future cash flow at the time when the consumer concludes the contract and has to estimate its future effect. Economic contract theory has shown that all long-term contracts (especially in labour law) suffer from the false assumptions underlying a sales economy with spot contracts, where the essential terms of a contract should be defined at the beginning.<sup>3</sup> Since only repeat players, who deal with thousands of similar contracts, have the statistical evidence as to the decisive underlying conditions, the supplier side alone is in a position to predict the possible outcome of this contract. Consumers can reduce the risks through a better informed decision with the help of test and consumer associations. But they will never be able to achieve the same level of sophistication as the supplier side. This is why the legislator has for hundreds of years framed this sector with special rules governing usury and default, keeping the possible outcomes of the transaction within certain limits and

<sup>1</sup> Udo Reifner, 'Impact of Directive 2002/65/EC concerning the distance marketing of consumer financial services on the conclusion of cross-border financial service contracts between professionals and consumers', EU Project No SANCO/2006/B4/034, Final Report Part I: General Analysis p 11.

<sup>2</sup> See for this relation the analysis of problems and institutions in Blankenburg and Reifner, *Rechtsberatung – Soziale Definition von Rechtsproblemen durch Rechtsberatungsangebote* (The social definition of legal problems by legal advice institutions) (Luchterhand: Neuwied 1982) 17 ff, 133 ff and the practical use of this insight in an action research project concerning the transformation of a consumer organisation into a financial advice institutions in: Reifner and Volkmer, *Neue Formen der Verbraucherrechtsberatung* (Nomos: Baden-Baden 1981).

<sup>3</sup> Bolton and Dewatripont, *Contract Theory* (MIT Press 2005); Gerrit de Geest (ed), *Contract Law and Economics* (2<sup>nd</sup> edn, Edward Elgar: Cheltenham 2011).

enabling consumers to take the risks involved. This is true for all types of long-term contracts in the fields of consumption, labour and public services.

Financial services are, however, abstract and their content are defined mostly by relatively abstract legal rights and duties in accordance with the contents of the contract and its fine print. Suppliers are tempted in these circumstances to create a veil over simple payments and risks. This artificial complexity is visible through the various denominations of prices and risks and cannot be cured by information rights. This would create an infinite recourse and a vicious circle in which ever more information rights lead to ever more unnecessarily complex products and product appearances.

Consumer protection in financial services does not therefore differ in principle from consumer protection in general. Consumers want affordable products and services which are adequate for their needs. They need the same protection in this area as they do in relation to all the other goods and services they need. As far as an artificially created complexity is concerned, it is the task of bank supervision to reduce it either to a necessary and manageable level or to take over certain functions on behalf of consumers and provide state approved and adequate products.

## 2. 'Consumer protection' in financial services – a new task in EU financial supervision

Since the financial crisis has shaken financial markets and created political turmoil, traditional consumer protection has left the realm of private law and entered state supervision. While consumer interests are cited in the private law sections of the 'Consumer Directives', for example in the Consumer Credit Directive 2008/48/EC, the Distant Marketing in Financial Services Directive, the Payment Directive or the e-commerce Directive, the parts of the directive which address issues of public law and supervision refrain from making any reference to consumer protection. The recent UCITS Directive 2009/65/EC on investments is typical as it does not refer to 'consumer protection' but uses the word 'consumer' to qualify organisations, legal action (article 107) and certain disputes (article 100).

### 2.1. Consumer protection in EU-bank supervision

The new system of financial regulation and supervision (ESFS) tries to coordinate and unify the newly created coordinating bodies of bank (EBA), insurance and occupational pension (EIOPA) and securities supervision (ESMA).<sup>4</sup> Still in its umbrella regulation there is no direct reference to consumer protection. But the *need for the protection of depositors, investors and consumers across the Union* is acknowledged in Recital 22 of the specific regulations. One article in each regulation cites consumer protection in its

<sup>4</sup> Regulation (EU) No 1092/2010, Regulation (EU) No 1093/2010, Regulation (EU) No 1094/2010, Regulation (EU) No 1095/2010; see also the proposal of September 23, 2009 COM(2009) 501 final. Accessible from <[http://ec.europa.eu/internal\\_market/finances/committees/index\\_en.htm](http://ec.europa.eu/internal_market/finances/committees/index_en.htm)>.



heading, however its transposition in the first paragraph refers only to fact-finding and education.

According to article 12(1) and (5) of Regulation 1092/2010, *consumers* (as well as producers) of *financial services* will be represented in its central scientific advisory body. Similar representation is foreseen in article 37(2) of the banking (and the other sectoral) supervisory regulations 1093/2010 for the newly created stakeholder group. In recital (22) of this Regulation the *need for the protection of depositors, investors and consumers across the Union* is acknowledged. Recital (48) enumerates consumers among other 'users' of financial services including SMEs, businesses, institutional investors, trade unions etc. Article 8(2)(i) of this Regulation adds consumer protection to the goals of developing 'common methodologies for assessing the effect of product characteristics and distribution processes on the financial position of institutions and on consumer protection'. Finally, article 9 of the Regulation addresses consumer protection directly in its heading 'Tasks related to consumer protection and financial activities'. However, only the first paragraph takes up this issue and makes no direct reference to 'consumer protection', merely defining certain limited measures with respect to data collection, education and rules of disclosure.<sup>5</sup> Identical rules exist in the insurance and investment regulations.

Similar developments can be seen at the national level. The newly created American consumer protection authority in financial services<sup>6</sup> may be the leading example of the incorporation of consumer protection into financial services supervision, although the scope of its activities was strongly limited during parliamentary discussions and its proposed budget by the Obama administration is currently coming under pressure to be reduced.

Most authors approve of the development of a separate unit for consumer protection in the area of financial supervision. Where this could be situated varies according to national tradition and culture. A strong central bank close to the political class, as in France, views itself as a natural place to defend consumer interests. In the UK, where there is a vast private financial market, agencies like the Office of Fair Trading have been preferred. In Germany, the existence of strong state-subsidised consumer organisations allows for the proposition that civil society is capable of taking over the functions of financial supervision.

This consensus as to the general idea of consumer protection and the need for an institution capable of advocating by representing this idea however lacks momentum in its translation into practice.

<sup>5</sup> 'The Authority shall take a leading role in promoting transparency, simplicity and fairness in the market for consumer financial products or services across the internal market, including by: (a) collecting, analysing and reporting on consumer trends; (b) reviewing and coordinating financial literacy and education initiatives by the competent authorities; (c) developing training standards for the industry; and (d) contributing to the development of common disclosure rules'.

<sup>6</sup> See Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub.L. 111-203, H.R. 4173): Title X: Bureau of Consumer Financial Protection.

Are we really talking about the same things when consumer protection is evoked? The legislator has left the notion of consumer protection to the public. Although it is cited widely as a general goal, other language is deployed where defined measures are at stake.

The existing proposals begin with consumers or investors, users or stakeholders. The aim is to improve consumer information or even to educate both consumers and suppliers, or to collect data and guarantee consulting from the consumer side.

In this context, the World Bank defines consumer protection as market enforcement including consumer education measures:

- (1) consumer disclosure should be simple, easy to understand and comparable; (2) abusive business practices by financial service providers should be prohibited; (3) consumers should have an easy, inexpensive and speedy method of resolving disputes with financial institutions; and (4) financial education should be available to consumers so that they can understand financial services and products and make informed decisions.<sup>7</sup>

Some argue that a stable financial system as such protects consumers and therefore fulfils the goals of consumer protection. This confuses the question what is good for consumers with the question of what consumers need (i.e. the 'general interest'). Since financial stability is part of the general infrastructure of society, any group of citizens and market participants will profit from traditional bank supervision with its focus on bank safety and soundness. This is why consumer protection could at the same time be called workers' as well as employers' protection, be part of protection for tenants and landlords and protect suppliers' and commercial investors, who would thus be identified with consumers.

## **2.2. Bank supervision and consumer protection under national law**

Under national law it is possible to distinguish between states which have a fairly strict firewall between consumer protection and bank supervision (like Germany), those which integrate consumer protection as a goal (like Sweden) and those who have specific administrative institutions for the supervision of compliance with consumer protection rules as defined above. The last two groups form 18 out of 27 Member States. Two-thirds of the experts confirmed that consumer protection was an explicit legal goal of the agencies. Among those were experts from Poland, Portugal, Slovakia, France, Bulgaria, Denmark, Lithuania, United Kingdom, Slovakia, Slovenia, Malta, Hungary, Ireland, Italy, The Netherlands, Norway (since 2010) and Spain.<sup>8</sup> Belgium is changing the supervisory mandate for its new conduct-of-business supervisor, which will contain a consumer protection objective.

<sup>7</sup> S Rutledge, A Nagavalli, R Lester & R Symonds, 'Good Practices for Consumer Protection and Financial Literacy in Europe and Central Asia: A Diagnostic Tool' (2010) The World Bank ECSPF - Finance and Private Sector Department Working Paper 001, i.

<sup>8</sup> Spain: response from Dirección General de Seguros y Fondos de Pensiones.



Nevertheless, experts of **9 countries** excluding or not mentioning private consumer protection (Slovenia, Finland, Germany, Greece, Belgium, Spain,<sup>9</sup> Austria and Estonia) often reported that the interests of consumers were indirectly protected through other goals and tools of their supervision, such as market-supervision, conduct of business, solvency and compliance rules. The experts therefore often distinguished between 'classical' or 'direct' and 'indirect' or 'unintended' consumer protection as illustrated in the following examples:

In **Slovenia** the Insurance Supervision Agency's expert reported that the goal of the Insurance Supervision Agency was the supervision of the insurance market. However, because the stability of the insurance market is indirectly in the interest of consumers (the insured), their interests were protected. In **Belgium** the expert from the Banking, Finance and Insurance Commission (CBFA) reported that the CBFA currently did not have a fully-fledged statutory consumer/investor protection objective in respect of financial services. However, the Law of 2 August 2002 on the supervision of the financial sector, establishing the CBFA and defining its competencies, would have a protective effect on consumers through compliance-observation.<sup>10</sup> The aims of these provisions were the protection of the consumers of financial services. Furthermore, articles 27 to 28bis of the Law of 2 August 2002 introduce conduct of business rules and client information obligations that apply in connection with the provision of investment (or ancillary) services (those articles transpose in Belgian Law article 19 (mainly) of the MiFID). By virtue of article 28ter, a Royal Decree (to be taken) can apply the provisions of articles 27 to 28bis to other categories of financial brokers (in particular insurance brokers and banking/investment services brokers). FPS Economy is responsible as regards the Law on market practices. The expert from **Spain's** Banco de Espana pointed out that the agency supervises compliance with banking regulations, which included not only prudential regulation but also customer protection regulation, among others. The **Austrian** expert does not consider the Financial Market Authority (FMA) to be a consumer protection organization in the traditional sense. Its contribution to consumer protection would lie only in the supervision of solvency, the market and conduct. In this sense the FMA would protect the consumer only on a general basis, but it does not help the individual consumer to enforce any potential damages claims or claims against supervised companies as these

<sup>9</sup> Spain: response from Banco de Espana.

<sup>10</sup> The Law of 2 August 2002 on the supervision of the financial sector lists amongst the CBFA's missions: - to ensure compliance with the rules aimed at protecting the interests of the investor in transactions in financial instruments, - to contribute towards compliance with the rules aimed at protecting savers and investors against the illegal offer or supply of financial products and services, - to ensure supervision of compliance with the provisions of the Law of 25 June 1992 on the insurance policy, in particular the verification of compliance by insurance companies with the provisions in the law that regulate (life and non-life) insurance contracts, - to ensure supervision of operations by mortgage credit institutions, as referred to in the Law of 4 August 1992 concerning mortgage credit, - to ensure supervision of compliance with the provisions of the Law of 27 March 1995 on (re)insurance brokers and the Law of 21 March 2006 on banking and investment services brokers, in particular as regards the information to be provided to clients and the identification of clients' needs, - to ensure supervision of compliance with the provisions of Title II, Chapter I, Section 4, of the Programme Law (I) of 24 December 2002, relating to supplementary pensions for the self-employed, - to ensure supervision of compliance with the provisions of the Law on supplementary pensions and on tax regulations applicable to such pensions and to certain additional social-security benefits.



are civil court matters. Even in **Finland**, where consumer protection is not an explicit goal, the text of the legislation nevertheless quite clearly implies by use of the term 'customer protection' that the protection extends to both business and consumer customers. According to the **Estonian** Financial Supervision Authority there is no explicit rule or other 'high-level' general provision for the protection of consumers of financial services, but the existing explicit goals of the supervision (enhancement of the stability, reliability, transparency and efficiency of the financial sector) all had the objective of protecting the interests of clients and investors by safeguarding their financial resources. **Germany** is an example of a strict separation between public supervision and private consumer protection. § 6 Abs. 2 of the Bank Law (KWG) limits the task of the bank authorities to problems which 'threaten the safety of assets entrusted to these institutions, the orderly business of banking and financial services or create significant disadvantages for the national economy'. Consumers are mentioned only to qualify products ('consumer credit') or organisations to whom the law intends to refer.

### 3. Which 'consumer protection'?<sup>11</sup>

Since the 1962 Kennedy declaration, consumer protection in contract law has been accepted as a core element of market economies. But in spite of its widespread use little has been achieved in its definition. The reason is that contract law used 'consumption' not as the telos of consumer protection but only to define those especially legal persons who should not profit from its legislation. This may change now since administrative law has entered the discussion and requires clear guidance as to where supervision for consumers should lead.

#### 3.1. The discussion on the reform of bank supervision and the consumer

There is a wide range of statements and expertise from government agencies, private banks, international consultancies and consumer organisations about the place consumer protection should have in future bank supervision.<sup>12</sup> Most of those studies which address the overall reform of financial supervision equally address this issue.<sup>13</sup> In some respec

<sup>11</sup> See Reifner, Niemi-Kiesiläinen, Huls, Springeneer, *Overindebtedness in European Consumer Law Principles from 15 European States* (Norderstedt 2010) 54 ff.

<sup>12</sup> Thorun, Chr: *Verbraucherorientierte Finanzaufsicht* (2010); vzbv: *Verbraucherschutz Finanzmarktregulierung* (2010); ConPolicy *Verbraucherorientierte Finanzaufsicht: Lehren aus britischer und irischer Erfahrung* (mandated by the German Consumer Federation vzbv 2009); World Bank CGA *Consumer Protection Regulation in Low-Access Environments* (2010); J Kessler, H-W Micklitz and Reich: *Darstellung der Arbeitsweise von Finanzaufsichtsbehörden in ausgewählten Ländern und der Verbraucherorientierung* (2009) (mandated by the German Consumer Federation vzbv); U Reifner: *Bank safety and soundness - The Bergamo Report* (Hamburg: Institute für Finanzdienstleistungen, 1996).

<sup>13</sup> B Deletré, *Rapport de la Mission de Réflexion et de Propositions sur l'Organisation et le Fonctionnement de la Supervision des Activités Financières en France* (French Government, Inspection générale des Finances N°2008-M-069-02 Paris January 2009); Deloitte, *Center for Banking Solutions, The Structure of Financial Supervision - Approaches and Challenges in a Global Marketplace* (mandated by the Group Thirty inc. October 6, 2008); J Armin: *Supervision and Regulation of Financial Institutions in Europe* (2006); K Lanno, JP Casey and A Sutton: *EU financial regulation and supervision beyond 2005* (Brussels: Centre for European Policy Studies, 2005); Rosa M Lastra: *The governance structure for financial supervision* (2005).

they start anew at zero ignoring the discussions in civil law in the early 1970s when the question arose whether consumer protection was a contradiction to the principle of legal equality in civil law. The challenge of the first national consumer protection laws outside civil codes like the German Standard Contract Terms Law of 1976<sup>14</sup> led to a number of theoretical approaches on the role of consumption in capitalist society before the Nobel Prize winning theory of asymmetric information reduced it to informational deficits in market transactions. The new spread of consumer protection to administrative law<sup>15</sup> after its integration into the new area of consumer law<sup>16</sup> is very much like its predecessors occupied with the question whether consumer protection, whatever it could mean, should be part of bank supervisory law.

Keßler et al.<sup>17</sup> argue on behalf of German consumer organisations that, according to both the European Treaty and the German constitution, it is the 'task of bank supervision to enforce the rules of consumer protection which serve a well-informed consumer'. ConPolicy, in their study of the situation in the UK and Ireland, conclude that consumer protection is an integral part of bank supervision and has proven itself to be very significant – a remarkable statement in view of the situation of consumers in these countries following the financial crisis. The World Bank (ECSPPF) states that 'the importance of consumer protection and financial literacy for the long-term stability of the financial sector [certainly the core goal of bank supervision *iff*] has been highlighted by the recent turmoil in financial markets world-wide'. Since we do not share the optimism as to financial education, consumer protection as legal protection certainly has significantly greater weight for the welfare of consumers.

It distinguishes between the traditional task of bank supervision, which is to guarantee *safety and soundness* and *conduct of business rules* which represent the area of consumer protection.

Financial regulation is also designed to protect customers and investors through business conduct rules. Particularly in cases where transparency

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regulation and supervision in Europe (London: London School of Economics, 2003); P Martín-Aceña and T Tortella, 'Regulation and Supervision: The Rise of Central Banks' Research Departments' in S Battilossi and J Reis (eds) *State and Financial Systems in Europe and the USA* (2010) 139; D Masciandaro and M Quintyn 'Institutions matter: financial supervision architecture, central bank and path-dependence' (2010) 8(1) *South-Eastern Europe Journal of Economics* s 7-53; Netherlands Bank DNB: *The Supervision of Banks in Europe: The Case for a Tailor-made Set-up* (2008); C Ohler 'International regulation and supervision of financial markets after the crisis' (2010) *European Yearbook of International Economic Law* s 3-31; S Stolz: *Banking supervision in integrated financial markets* (Munich: CESifo, 2002).

<sup>14</sup> For an overview see N Reich, *Markt und Recht – Theorie und Praxis des Wirtschaftsrechts in der Bundesrepublik Deutschland* (Theory and Practice of Commercial Law in Germany) (Neuwied 1977) 179 ff.

<sup>15</sup> See the multitude of consumer law journals and book series like *Journal of European Consumer and Market Law*, Springer Vienna, New York first issue 2012; 'Verbraucher und Recht', Nomos Baden-Baden; *Journal of Consumer Policy* (JCP) etc.

<sup>16</sup> See the French example of umbrella legislation in the Code de la Consommation (1978) followed by the Italian Codice del Consumo (2005)

<sup>17</sup> J Keßler, H-W Micklitz and N Reich, *Darstellung der Arbeitsweise von Finanzaufsichtsbehörden in ausgewählten Ländern und deren Verbraucherorientierung* (2009).



requirements alone are insufficient, investors are protected by rules that mandate fair treatment and high standards of business conduct by intermediaries. Conduct-of-business rules ultimately lead to greater confidence in the financial system and therefore potentially greater market participation. Business conduct regulation has a quite different focus from safety and soundness oversight. Its emphasis is on transparency, disclosure, suitability, and investor protection. It is designed to ensure fair dealing. Such standards have been widely adopted in securities regulation for several decades. The sale of risk products to individuals traditionally was viewed as an appropriate area for substantive conduct regulation. Classic examples of business conduct rules include conflict-of-interest rules, advertising restrictions, and suitability standards. Some observers claim that business conduct rules per se were less common in the banking sector, although fiduciary principles applied. As banks have ventured further from their original business models and have become more active purveyors of risk-based products and services, particularly to retail customers, banking regulators are applying business conduct restrictions more broadly.

Although consumer protection in financial services is a widely shared principle, denoting in particular a significant body of national consumer law, there is no unanimity as to its precise significance. The interpretation of what consumer protection means varies widely. It is seen by some as merely a form of market protection or compliance, by others as analogous to food and health supervision; some consider consumer protection as a remedy for informational asymmetry in the markets or as a means of enabling access to goods and services available in the market; some see it as a means of providing good and services of first necessity or minimum standards in terms of the quality and functionality of the products. The evaluation of existing or envisaged financial supervision is problematic as long as there is no consensus about the meaning and purpose of consumer protection in financial services.

### 3.2. Which 'consumers' need protection?

The main goal of consumer protection is to defend and promote the interest of 'consumers'. BEUC refers to 'general interests of consumers' and 'consumers' organisations' in its statutes which exclude 'state, industrial, commercial, party political and trade union interests', and therefore distinguishes its target group from other more general notions of market participants like 'clients', 'users' or '(retail) customers'. In other words, it includes all individuals and institutions or organisations which may be affected by products in the market.

It therefore shares the approaches taken by the EU Consumer Directives, which are summarised in part in article 2(1) of the Commission's Proposal for an EU Directive on Consumer Rights of October 8, 2008<sup>18</sup> which defines 'consumer' as 'any natural person

<sup>18</sup> COM(2008) 614 final.

... acting for purposes which are outside his trade, business, craft or profession'. A similar definition may be found in the Consumer Credit Directive 2008/48/EC article 3(a) where 'consumer' is 'a natural person who, ..., is acting for purposes which are outside his trade, business or profession'.<sup>19</sup>

Some national legislation broadens the scope of the definition by including small businesses and self-employed persons. However, these concepts apply legal fictions in order to be able to provide protection to other groups of society through the use of legal analogy. This is also true where national jurisprudence includes the acquisition of goods and services which are of dual use into their concept of consumer protection. On the other hand, restrictions which render consumer directives inapplicable to certain goods or to certain groups of consumers (e.g. mortgage loans in the Consumer Credit Directive) do not challenge the general classifications.

From a sociological point of view, and with reference to 'the general interests of consumers' as mentioned in the BEUC statutes, the American legal definition would appear to have advantages. It takes a positive approach by referring directly to consumption. Thus, in the context of consumer credit protection, the money borrowed by consumers is defined as serving 'primarily for personal, family, or household purposes'.<sup>20</sup>

As far as consumer protection is concerned, many proposals for implementation in financial supervision identify consumers as savers and investors. From a consumer viewpoint, however, clear distinctions are required here. Savers use financial services because they want to have their money somewhere safe and administered in a conservative fashion. They have a clear goal to use this money in the future either for specific consumption purposes or to cover unforeseen risks and events. Although the authors would like to stress that there are distinct categories of investors deserving a differentiated focus on their level of protection, the term 'retail investor' is used, somewhat reluctantly, to refer to consumers of financial investment services and saving products, because it is the more widely used terminology at the European level and includes both savers and those who invest their money in long-term products for their retirement.<sup>21</sup>

<sup>19</sup> EU Consumer Credit Directive ('CCD 2008', Directive 2008/48/EC) - Directive on credit agreements for consumers <<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:133:0066:0092:EN:PDF>>.

<sup>20</sup> See §103 (h) Consumer Credit Protection Act.

<sup>21</sup> Although the distinction we make may at first sight appear to be analogous to the identification of a 'sophisticated investor' who knows a lot about investments, takes more risks and could be more wealthy, it is fundamentally different in the sense that the distinction is based on 'purpose' or 'motivation' of the 'retail investor'. E.g. while certain savers may be investors when they choose products which provide an increased amount of money in the future which is generally linked to a certain risk of losing some of this money (risk-return trade-off), such investors are 'consumers' when the amount of the investment and the primary goal remains connected to consumption. Institutional investors are already, by definition, not consumers. Furthermore, though not treated conceptually as such by all observers, personal investors can be seen as having specific interests which are different from consumer interests when they invest a significant sum of money with the sole intention of increasing the value of the capital in the future for yet further financial investments.



In countries where no limits are set, by consumer credit legislation, to the amount of credit which is protected under consumer protection legislation, courts have used a 'professionalism' approach to exclude commercial investors from consumer protection. If a credit has been taken out with respect to a fortune, i.e. for its management needs in terms of professional skills and third party expertise, such borrowers would not fall under the notion of 'non-commercial' consumers as defined in the consumer directives. Confusing commercial with consumer investors is dangerous for consumer protection since both groups do not share the same concern. There is certainly a need to protect all investors including both consumer investors with authentic savings intentions as well as commercial investors who only want to maximise their assets. However, there are specific consumer interests that require a different and more fundamental protection from the State because they concern human needs, lives and the well-being of families. Such consumer investors should be entitled to receive the same protection as shorter-term savers, borrowers for personal use, consumers who take out policies covering risks such as life, accident or health insurance, or those consumers who use the payment systems to allocate their monthly income where they need it. If policymakers are able to distinguish between retail consumers who need their money and individuals who want to make money through the search for higher yields, this will assist the development of more appropriate policies focussed on delivering the outcomes desired by market participants.

If a person is a commercial investor seeking returns, freedom to place one's funds where one sees the highest yields becomes the overriding priority, whereas a consumer investor saving for retirement will place a greater emphasis on protection and thus justifies the need for a dedicated authority with the requisite mandate.<sup>22</sup>

Since the primary goal of this expertise is consumer protection the word 'saver' should not only be used for those buying saving products but also for such investors whose primary concern is to secure future consumption and to allocate present income where it is needed in the future. The word 'investor' without further specification should instead refer to financial users who at least partly perform commercial investment.

### 3.3. Which problems require management?

While the general question whether capitalist markets need not only prudential and professional supervision as well as a framework enabling fair and effective competition but also consumer protection has brought little enlightenment about what consumer protection could be, the examples where one would expect its benefits are quite interesting. In its working paper,<sup>23</sup> the World Bank has identified a number of problems which it attributes to the financial crisis. However, its analysis is difficult to apply since it reduces consumer protection to a fairly limited set of tools, a perspective which is shared neither by national legislation nor by consumer organisations in Europe.

<sup>22</sup> This is irrespective of the exact details of regulation monitored by the authority e.g. in Sweden, where pension funds for old-age pension savings may not guarantee the amount of the starting capital.

<sup>23</sup> See n 7.

In its *Ljubljana Declaration* on 'Consumers and Financial Services: Towards financial security for all consumers', BEUC provided an analysis of the role of consumer protection with regard to the financial crisis. It blames (1) the lack of regulation and (2) the ineffectiveness of existing supervision, which does not take into account the whole life cycle of a product, (3) the mis-selling of financial products and the creation of unsafe services, (4) insufficient and inappropriate financial advice and (5) the exclusion of vulnerable consumers. It is obvious that, given the remedies proposed by the World Bank for more consumer protection in financial services, its recommendations do not share the same analysis.

In this respect, the public debate seems lean towards the BEUC analysis when it declares that the crisis is a 'subprime crisis' in which debtors were exploited by irresponsible lending practices or as a crisis for savers who lost part of their wealth in the investment markets.

The following table identifies more closely some of the problems which call for greater consumer protection.

**Table 2: Examples of consumer problems in financial services**

Categories	Examples
<b>Cross-cutting consumer protection concerns</b>	
<b>Product transparency: Consumers do not understand the service's total cost</b>	Deceptive advertisements, excessive small print, complicated terms, inadequately trained staff, etc.
<b>Overcharging</b>	Unauthorised additional fees and commissions
<b>Sales practices</b>	Aggressive sales techniques as part of door-to-door solicitations or limited-time offers.
<b>Inadequate documentation</b>	Consumers do not receive copies of contracts, receipts, etc.
<b>Privacy, security, permission to share with third parties</b>	Personal data is not treated appropriately
<b>Recourse</b>	Consumers do not know that they have the right to complain or get errors resolved; they may know they have this right, but do not know how and where to complain; they know how and where to complain, but fail to receive appropriate redress.
<b>Product-specific concerns</b>	
<b>Deposit products/ Pensions/ Securities</b>	Consumers' savings are eroded by hidden fees or deposits are lost to fraud. Including mis-selling and biased advice, inability to understand risks, complexity of products.
<b>Credit</b>	Consumers do not understand the terms and conditions of their loan agreement, e.g., what happens in the event of delinquency or default; in case of credit in foreign currency (see Latvia and Hungary) or the impact of non-capped variable rates (unsuitable



	credit); they pay a high price; they take on too much debt; they are exposed to loan officers who ask for a 'gift' to complete the loan process, to recommend a larger loan, or to expedite loan approval; they are subject to intimidation, abuse, or humiliation by collection staff/agents.
<b>Payments services</b>	Consumers lose their personal identification number, have it intercepted electronically by a fraudster, or simply face excessive surcharges by some sellers (see Ryanair).
<b>Insurance</b>	Consumers do not understand, or they fail to receive, policy benefits (e.g., they do not receive the full benefit when a family member dies); they do not realise that the loan price includes credit life insurance, and so are paying more than expected and failing to benefit from the insurance.

In conclusion, consumer protection should be about consumer problems. The enormous number of proposals as to how to address consumer problems and the lack of corresponding analysis about the problems actually endured by consumers as a result of the crisis encourages the suspicion that consumer problems are often defined by the remedies that the interested parties want to sell. If, for example, extended prudential regulation is seen as a genuine element of consumer protection, consumer interest loses its quality as a legitimate special collective interest which only transforms into a general interest within a democratic decision making process (legalisation) where they compete for the general good with interests for market stability, internationally competitive power of European financial institutions, stability of the currency, professional ethics, effective employment and protected labour etc. They are in its genesis already reduced to what is permissible under prudential goals. Where their interest is already turned into legal rights it is even illegal to subsume them to other goals than those defined by the law.

Consumers are of course natural persons and citizens. As such they may exercise the profession of a banker or be employers. But consumer protection only addresses the specific interests where they use goods and services for personal consumption. Whether a certain requirement for safe and sound banking is suitable for them can only be judged from this perspective and not imputed in general. With regard to the second pillar of banking supervision, namely 'rules of fair business conduct', such rules may overlap with direct consumer protection but they concern consumer problems only where consumer interests are directly undermined. Providing a better financial system is an important public goal but not in itself consumer protection.

Consumer problems should be distinguished from the problems caused by poor business conduct and the problems which could arise through insolvency.

Consumer problems during the financial crisis may be split into the two elements of financial contracts, which are an identical feature of both sides of the contract, namely that both the service and the price are expressed in money terms.

At the level of price, subprime interest, low yields, high premiums, additional fees all damage consumer interests. At the capital level, part may be withheld through disagio,agio, it can be lost where nominal and real value deviate and it can be turned into negative debt capital where cost elements are financed and debited.

Such problems can be dealt with directly by the law. Regulation or supervision in this context concerns the design of the product, its marketing, servicing and enforcement. For example, savings products in general require permission to enter the market in France. Pension products require approval in Germany if they want to benefit from tax exemptions. Most traditional consumer protection rules under national law regulate the product directly in the form of the rules creating interest rate restrictions on credit, and rules concerning the investments made by funds.

These problems can also be addressed indirectly where market forces are seen as the dominant actor in addressing consumer problems. In these cases, rights are attributed to consumers which reinforce their role as active market participants.

**Table 3: Examples of consumer problems in kind and in choice**

	Credit	Savings/ Pensions	Insurance	Payment
Consumer Product				
Price	Usury, extra fees, kick-back provisions	Fees, provisions, churning	Fees, provisions, churning	High and opaque fees
Capital	Financed fees, premiums, refinancing deductions	Deductions, spread between nominal and real value, losses from risky investments	Negative initial value	
Liquidity	Early termination, revolving	Frozen assets, high losses for early termination, 'just-out-of-time'	no risk coverage, exemption clauses, unnecessary	Extended time for transfer
Access	Denied or risk based pricing	Minimum requirements, threatening fees	Black listing	Intimidating fees and interest for low income
Enforcement	Foreclosure, debt collection, black listing			
Consumer Choice				



<b>Competition</b>	Cartel, fair competition
<b>Information</b>	Transparency, APRC, yield, prospects, changes etc.
<b>Advice</b>	Explanation, documentation, liability

### 3.4. What kind of "protection" is required?

Consumer protection is interpreted in a number of ways in EU policies. While the Commission has increasingly used the term 'consumer advantages' to describe its understanding of consumer protection within the EU single market, consumer organisations have focussed on the promotion of the 'general consumer interest'. The differences have a significant impact on the analysis. While arguments of consumer advantage reduce consumer interest to money interests, consumer protection targets the whole process of consumption.

For example, the Cecchini report<sup>24</sup> and the European Court of Justice<sup>25</sup> have argued that a common internal market is in itself an advantage for consumers, as it has provided increased choice and competition, which is said to reduce prices for consumers. Using that definition, it would suffice to demonstrate that financial supervision ensures that financial markets function well. Consumers and users would thus share the same interests. Bank supervision designed to create safe and sound banking could then be called consumer protection.

In its papers concerning the management of the financial crisis, the OECD<sup>26</sup> defines consumer protection in a similar way to the World Bank,<sup>27</sup> taking a market fairness approach and protecting both consumers *and* investors. It says:

The objective of consumer protection is not well defined. If regulation is correctly designed and properly enforced, it sustains consumer and investor confidence, which is necessary if the financial system is to attract capital and function efficiently. Market confidence and consumer protection are undermined if the financial system is not adequately protected from abuses. Economic exchange, in general, and financial transactions in particular rely importantly on trust and confidence. Financial transactors must have some assurance that financial markets and institutions are safe and sound, and operate according to rules and

<sup>24</sup> Europe 1992: The Overall Challenge [Cecchini Report] SEC (88) 524 final, 13 April 1988.

<sup>25</sup> Case C-233/94 *Germany v European Parliament and Council* [1997] ECR I-2405 para 48: 'In that regard it suffices to point out that, although consumer protection is one of the objectives of the Community, it is clearly not the sole objective. .... however, no provision of the Treaty obliges the Community legislature to adopt the highest level of protection which can be found in a particular Member State. The reduction in the level of protection which may thereby result in certain cases .... does not call into question the general result which the Directive seeks to achieve, namely a considerable improvement in the protection of depositors within the Community'.

<sup>26</sup> S Lumpkin, 'Consumer Protection and Financial Innovation: A few basic propositions', OECD Journal of Financial Market Trends 2010 – issue 1 p 117 ff (Principal Administrator in the Financial Affairs Division of the OECD Directorate for Financial and Enterprise Affairs.)

<sup>27</sup> See n 7.

procedures that are fair, transparent, and free from conflicts of interest and other agency problems.

This statement contrasts significantly with its assessment of the reasons for consumer problems:

It is not a great oversimplification to suggest that the issue of financial innovation and consumer protection is mostly about access and suitability. Access refers to a situation in which affordable, mainstream financial products are available to all segments of the population across the range of income levels and demographic characteristics. Suitability addresses the appropriateness of the products for particular consumer groups. That is, what products may safely be sold to retail financial consumers? By whom? Who decides? And whose fault is it if something goes wrong?

But instead, through its focus on *access, suitability, safety, suppliers, deciders and fault* when analysing the problems of the crisis, OECD returns to a well-functioning market where primarily 'asymmetric information' could be cured by 'fair behaviour'.<sup>28</sup>

In the second chapter of its 'Consumer Policy Toolkit' 2010, the OECD gives broader insight into its philosophy of consumer protection where it describes the sources of its view, namely the neo-classical approach tempered by 'behavioural economics'. Needs orientation in consumer protection as required by law and researched in consumer sociology is still kept outside the realm of a purely economic definition of consumer protection.<sup>29</sup> The implicit identification of 'consumer policy' with its first two parts ('information'), substituting its third part 'consumer protection'<sup>30</sup> with a consumer policy approach defined in this way creates a contradiction in itself.<sup>31</sup>

While information is manifestly a core element of consumer policy and plays a pre-eminent role in consumer information and consumer education, legal consumer protection must compensate for the loopholes in a system where knowledge about the irresponsible behaviour of suppliers, as experienced during the financial crisis, is not sufficient to protect consumers from the consequences of such behaviour. The 2009 report of the French government on financial supervision does not identify prudential regulation and investors' protection with consumer protection as such when it says:

*Ils proviennent des possibilités d'arbitrage réglementaire que ce système génère s'agissant des dispositions relatives à la protection du*

<sup>28</sup> Lumpkin (n 26) 6 ff.

<sup>29</sup> See subsequent sections of this report.

<sup>30</sup> While the text always refers to consumer policy, it suddenly states that 'those responsible for consumer protection must quickly respond to a rapidly changing and highly sophisticated marketplace' (Ch 1).

<sup>31</sup> Chapter 5 of the consumer policy toolkit hides 'prohibition' under a pile of informational tools: 'Consumer awareness and education, Information provision and disclosure, Contract-term regulation, Cooling-off periods, Moral suasion, Codes of conduct, Standards, Licensing and accreditation, Prohibitions, Dispute-resolution and redress mechanisms, Enforcement strategies'.



*consommateur de services financiers et aux obligations professionnelles à l'égard de la clientèle.*<sup>32</sup>

In fact this attitude deviates significantly from existing national legal principles. Under its general principle of shelter for the weak, the law seeks to protect consumers from the adverse effects of financial services on their life circumstances. This is done either in a demand-driven approach by providing information for self-help or in an offer-driven approach, protecting 'consumer needs' directly through substantive regulation.

The latest EU rules governing consumer investment and consumer credit have acknowledged this twin approach within national consumer protection. The focus is now on the 'suitability' and 'responsibility' of financial services<sup>33</sup> along with 'transparency' and 'fairness'. While the financial crisis has revealed that even highly sophisticated and skilled bankers were victims of irresponsible products, with the result that their institutions had to be rescued by the public, the neo-classical informational approach has undergone some questioning.

National case-law has already implemented this kind of consumer protection, which regulates the product itself, as opposed merely to how it appears in the form of public information, by defining the prevention of damage to consumer interests as a goal of consumer protection law.<sup>34</sup>

BEUC uses a more focussed definition of consumer protection when it states that it will 'promote, defend and represent the interests of European consumers' in article 2 of its statutes. On its website it makes a clear distinction between consumer protection and bank supervision when it claims that 'the crisis has shown that financial supervision authorities were not capable of detecting the risks of ever-more complex products correctly and of imposing the necessary measures to avoid this crisis' and aspires to 'strengthen regulation and supervision of the Internal Market for retail financial services in order to reinforce consumer confidence in the Internal Market'.

In BEUC's 8 Priorities for the Hungarian Presidency,<sup>35</sup> its 10<sup>th</sup> point on financial services: 'Enhance financial supervision' makes a distinction between prudential supervision and consumer protection when it says:

<sup>32</sup> B Deletré, Rapport de la Mission de Réflexion et de Propositions sur l'Organisation et le Fonctionnement de la Supervision des Activités Financières en France (French Government, Inspection générale des Finances N°2008-M-069-02 Paris January 2009) p 3.

<sup>33</sup> See art 19(4) Directive 2004/39/EC (MIFID): 'knowledge and experience in the investment field relevant to the specific product or service, his financial situation and his investment objectives so as to enable the firm to recommend to the client or potential client the investment services and financial instruments *that are suitable for him*' (emphasis added). For consumer credit see Recital (26) Directive 2008/48/EC: 'Member States should take appropriate measures to promote *responsible practices* during all phases of the credit relationship, taking into account the specific features of their credit market' (emphasis added).

<sup>34</sup> For Germany see Schwintowski, 'Die Grundsätze der anleger- und objektgerechten Beratung im Lichte des Geeignetheitstests' (§31 Abs-4 WpHG), in Festschrift Hopt 2010 S. 2507 ff.

<sup>35</sup> See <www.beuc.eu>.

In many Member States, national supervising authorities have been incapable of correctly detecting risks and imposing the necessary safety measures. If national supervisors are not doing their job properly, consumers are at risk. At EU level, the new European Systemic Risk Board (ESRB) and the three financial supervisory committees transformed into the new European Supervisory Authorities (EBA, EIOPA and ESMA) should start operating in 2011. This new architecture is focused on prudential supervision and does not take due account of the conduct-of-business side of supervision, despite the fact that links between prudential supervision and consumer protection in the financial services area are so obvious.

In its concrete demands, it requests that 'consumers' needs' be addressed.

In its ten principles of consumer protection,<sup>36</sup> the EU Commission declares EU law to be 'promoting consumers' rights, prosperity and wellbeing'. It is not, however, a general declaration of consumer policy which includes consumer information and consumer education alongside consumer protection. This position is aligned with the general theory on consumer policy.<sup>37</sup> Consumer protection is the legal part of consumer policy, so that citing only legal rights gives the correct insight that consumer protection is the enforcement of a law protecting consumers in the marketplace.

Consumer organisations therefore need their own definition of consumer protection covering all of their achievements in the form of the existing law on consumer protection. It concerns 'consumers' and not 'clients' or 'investors', which does not differentiate between an investment for consumption and an investment for commercial purposes. It further concerns legal protection in all its forms including the regulation of products and information on the demand side.

The Consumer Credit Directive 2008/48/EC which had been turned from its previous 2002 draft on substantive consumer rights regulating a comprehensive APRC, traps for overindebtedness like open end credit without issue, variable rates, chain financing, sham credit where investment and credit contracts are combined (endowment credit) including mortgage loans and overdraft. The final version omitted all consumer organisations had welcomed in this first try based on empirical research. The final version withhold even the only sensible and necessary information: an inclusive APRC to exercise rational choice and an early payment plan which could warn against future over-indebtedness. It now prescribes four times the same information on specific cost elements which the provider can define arbitrarily (Advertising: representative example article 4(2); Pre-Contractual: articles 5-7; Contractual Information: articles 10-11; Post Contractual Information during Credit Relation: article 12), offers a highly ideological right of withdrawal (Annex II (4)) which already in the past revealed inadequate for those who had received the money. It then even requires the disclosure of a misleading arbitrarily

<sup>36</sup> European Commission, 'Consumer Protection in the European Union: Ten Basic Principles' <[http://ec.europa.eu/consumers/cons\\_info/10principles/en.pdf](http://ec.europa.eu/consumers/cons_info/10principles/en.pdf)>.

<sup>37</sup> See references below in n 41 ff.



defined 'Borrowing Rate' (article 3(j)) which takes away any advantage the APRC could have in those minority of contracts where no ancillary services are provided, similar for the variable rate and its changes (Rec 32 EGBGB) where the information implies that providers can impose one-sidedly defined price conditions after a contract has been concluded while the payment plan (article 10(i)) is only available on request and after the consumer has overtaken the debt load. While these information rights at least aim at the consumer and his freedom a step toward 'consumer law' which no longer protects but regulates consumer is taken in the obligation to disclose private information in order to be denied credit in the strange principle of 'responsible lending' in article 8 and (the most visible sign of active lobbying) article 10(2)(r) where consumers and debtors deprived their right of early repayment without charges in the previous Directive 87/102/EEC.

But while this Directive had been defined by active lobbying already in 2004 in the European Parliament before the crisis broke out and due to public ignorance upheld in the legislative process until 2008 the regulatory philosophy at least at the abstract level has changed in the meantime.

Now the OECD/G20 high-level principles on financial consumer protection from October 14-15, 2011 provide a balanced approach for consumer protection wherein information is only one tool aside consumer rights which directly affect production and distribution of financial products and could be headlined with 'just and fair treatment' principles. It starts with information but continues with regulation and supervision.

- *Information and Transparency*: 'Appropriate information should be provided at all stages of the relationship with the customer. All financial promotional material should be accurate, honest, understandable and not misleading', 'Financial Education including information on consumer rights in order to assess financial risks and chances to make informed choice and to ask for help'.
- *Regulation*: 'Responsible Behaviour of Suppliers and Intermediaries, taking into account such consumer interest, concerning financial capability and social circumstances', 'Protection of Consumer Rights in Investment, Savings against fraud and misuse through adequate control mechanisms', 'Data protection "including" Complaint Management and Ombuds-Systems'.
- *Supervision* of: 'adequate Management', 'independent, responsible, adequate means, resources and competence, clearly defined sanctions, consistent procedures', 'high professional standards, confidentiality' preventing 'conflicts of interest'.

#### 4. Which remedies are appropriate - rights or information?

Consumer rights derive from consumer legislation which has been passed in many member states in a special body of 'Consumer Protection Acts'.<sup>38</sup> Since the Kennedy Declaration of 15 March 1962, the four original basic consumer rights have been

<sup>38</sup> For example France and Italy in general while specifically for financial services many more use the notion 'consumer' especially in credit law.

expanded into eight consumer rights.<sup>39</sup> While Kennedy focussed (with the exception of Right 1 to safety) on rights to a fair chance in the market, such as Right 2 - to be informed, Right 3 - to choose and Right 4 - to be heard, Consumer International added more substantial rights, such as the Right 5 - to the satisfaction of basic needs, Right 6 - to redress, Right 7 - to education and Right 8 - to a healthy environment.

Furthermore, article 169 of the consolidated version of the Treaty on the functioning of the European Union specified the role of the EU in consumer protection.<sup>40</sup>

This distinction in consumer rights underlies most national legislation and follows two distinct models of consumer protection.<sup>41</sup> The 'liberal model', founded by Adam Smith, lies at the root of 'homo oeconomicus' as the model consumer.<sup>42</sup> Homo oeconomicus has access to full knowledge of his own needs, of all available means of satisfying them, of maximising the use of resources, and he has unlimited scope for processing information. He has no preferences as to brand, time or place and makes decisions without being influenced by people or experiences. In other words, he is perfectly rational.<sup>43</sup>

This liberal approach does, however, acknowledge that this homo oeconomicus does not exist in a pure form, because complete information (on grounds of the sheer time and cost required, let alone intellectual capacity<sup>44</sup>) does not exist anymore than does spatial independence, because the perfect market upon which the model is based does not exist.

<sup>39</sup> World Consumer Rights Day - 15th March 2010. Theme of this year: 'Our money, our rights' at <[www.consumersinternational.org](http://www.consumersinternational.org)>.

<sup>40</sup> '1. In order to promote the interests of consumers and to ensure a high level of consumer protection, the Union shall contribute to protecting the health, safety and economic interests of consumers, as well as to promoting their right to information, education and to organise themselves in order to safeguard their interests.

2. The Union shall contribute to the attainment of the objectives referred to in paragraph 1 through:

(a) measures adopted pursuant to Article 114 in the context of the completion of the internal market;

(b) measures which support, supplement and monitor the policy pursued by the Member States.

3. The European Parliament and the Council, acting in accordance with the ordinary legislative procedure and after consulting the Economic and Social Committee, shall adopt the measures referred to in paragraph 2(b).

4. Measures adopted pursuant to paragraph 3 shall not prevent any Member State from maintaining or introducing more stringent protective measures. Such measures must be compatible with the Treaties. The Commission shall be notified of them.'

<sup>41</sup> The comments by Mitropoulos address this subject in greater depth in S Mitropoulos, *Verbraucherpolitik in der Marktwirtschaft: Konzeptionen und internationale Erfahrungen* (Duncker & Humblot: Berlin 1987) 4-98; cf. Hart and Köck, 'Zum Stand der Verbraucherrechtsentwicklung', ZRP 1991, p 61 ff (64).

<sup>42</sup> Cf. S Kind, *Die Grenzen des Verbraucherschutzes durch Information - aufgezeigt am Teilzeitwohnrechtgesetz* [Limits of Consumer Protection through Information] (Duncker & Humblot: Berlin 1998) 42; cf. F-J Hering, *Informationsbelastung in Entscheidungsprozessen: Experimentaluntersuchung zum Verhalten in komplexen Situationen* (Lang: Frankfurt a.M. 1986) 15; Leisner, 'Der mündige Verbraucher in der Rechtsprechung des EuGH', EuZW 1991, p 498 ff.

<sup>43</sup> E Kuhlmann, *Verbraucherpolitik: Grundzüge ihrer Theorie und Praxis* (Vahlen: München 1990) 30; S Kind, cf. *ibid* 43; F Böcker, *Marketing* (Lucius: Stuttgart 1996) 41.

<sup>44</sup> S Strassner, *Verbraucherinformationsrecht - rechtliche Grundlagen und rechtsökonomische Aspekte* (ÖR-Verl: Saarbrücken 1992) 128 f.



It instead forms the basis for a free and responsible model consumer,<sup>45</sup> who will digest the information and will then be in a position to take responsible decisions.<sup>46</sup>

Judgments of the European Court of Justice in relation to misleading advertising<sup>47</sup> also demonstrate a clear tendency towards this responsible consumer model. This model also underlies European legislation and this is most clearly expressed in the focus of European consumer protection rights on legislation making the provision of information to consumers compulsory.<sup>48</sup>

From this perspective, any information improves the position of the consumer, who is thus enabled to come to rational decisions.

On the other hand, in contrast to the liberal model, the 'social' model is based on the presumption of the hasty and needy consumer, forced into contractual relations by social circumstances he cannot control, someone lacking in concentration and in need of protection.<sup>49</sup> Using this approach, the State has a duty to protect consumers by controlling the market.<sup>50</sup>

Obligations to provide information must take into account that the mere availability of information is not enough.<sup>51</sup> Financially sane decisions presuppose above all the capacity

<sup>45</sup> S Kind, cf n 42, p 44; B Dauner-Lieb, *Verbraucherschutz bei verbundenen Geschäften* (Wertpapier Mitteilungen 1991) 144.

<sup>46</sup> Cf Blaurock, 'Verbrauchercredit und Verbraucherleitbild in der europäischen Union', JZ 1999 p 8 (802); Dreher 'Der Verbraucher – Das Phantom in den opera des europäischen und deutschen Rechts?', 1997 p 167 (171); C Heiss, 'Formvorschriften als Instrument europäischen Verbraucherschutzes' *Internationales Verbraucherschutzrecht - Erfahrungen und Entwicklungen in Deutschland, Liechtenstein, Österreich und der Schweiz*, Referate und Diskussionsberichte des Kolloquiums zu Ehren von FR Reichert-Facilides (Tübingen 1995) 90; S Mitropoulos, cf n 41, p 26.

<sup>47</sup> Traub, *Das Verbraucherleitbild in rechtsvergleichender Sicht* (Baden-Baden 1997) 19-22 with further examples; ECJ GRUR Int. 1990 p 955; Blaurock, cf n 46, p 802; ECJ judgment of 7.3.1990, EuZW 1990 222 (224); ECJ judgment of 6.7.1995, EuZW 1995 p 611 (612); Dreher, cf n 46, p 171.

<sup>48</sup> Cf Verbraucherpolitische Strategie der Europäischen Kommission 2002-2006, 3.3.2.1. and 3.3.2.2. Blaurock, cf n 46, p 802 f; Dreher, cf n 46, p 171; C Heiss, cf n 46; Mörner in P Cartwright (ed) *Consumer Protection in Financial Services* (SMU Institute of International Banking and Finance, Kluwer: Dordrecht (Texas), Den Haag 1999) 28; T Wilhelmsson, 'Information Duties as a Means of Protecting Insurance Consumers', AJuris 1998 p 71.

<sup>49</sup> Traub, cf n 47, p 31, 32; Tilman in *Festschrift für Henning Piper* (Beck: München 1996) 481; Köck and Hart, cf n 41, p 63; N Reich, 'Schuldrechtliche Informationspflichten gegenüber Endverbrauchern', NJW Juristische Wochenschrift 1978 p 513 (519); N Reich and H-W Micklitz, *Verbraucherschutzrecht in der Bundesrepublik Deutschland* (Van Nostrand Reinhold: New York 1980) margin note 3; N Reich, K Tonner and H Wegener, *Verbraucher und Recht: Überholte Konzeptionen, Lücken und Mängel in wichtigen Verbrauchergesetzen und die Praxis der Rechtsprechung* (Schwartz: Göttingen 1976) 74; BGH GRUR 1991 p 850 (851) and OLG Hamburg GRUR 1992 p 126 – both judgments in relation to misleading advertising; Baumbach and Hefermehl, *Wettbewerbsrecht* (8th edn 1995), art 3 UWG margin note 33.

<sup>50</sup> N Reich, K Tonner and H Wegener: l.c., preface, p I; Bartsch, ZRP 1973 p 13 ff; N Reich and H-W Micklitz: l.c., margin note 5; Damm, JZ 1978 p 173 (179); Köck and Hart, cf n 41, p 63; B Biervert, 'Verbraucherschutz', in Fischer-Winkelmann and R Rock, *Grundlagen der Verbraucherpolitik* (Rowohlt: Reinbeck 1977) 178.

<sup>51</sup> Breidenbach: Die Voraussetzungen von Informationspflichten beim Vertragsschluss, p 11; R Kempf, *Verbraucherschutzinstrumente* (Nomos: Baden-Baden 1994) 205.

to make transactions in relation to an actual social and financial situation.<sup>52</sup> To that end, the first requirement is that consumers make use of the available information.<sup>53</sup> The consumer's own response is a pre-condition for this. However, the manner and scope of responses relating to information depend on a number of factors,<sup>54</sup> not all of which will be affected by information, but which instead adapt this information. This must be taken into account in order for it to have any effect.<sup>55</sup> The main influences are as follows:

- Characteristics of the information materials available to the consumer, such as content and completeness of information, its form, and acceptance of the source of the information.
- Personal characteristics and attitude of the consumer, e.g. general level of education,<sup>56</sup> basic knowledge of the product,<sup>57</sup> needs.
- External circumstances surrounding distribution of the information, including the manner of distribution of the information and the time when the information was distributed.
- Human needs which, especially in relation to credit and debt, do not only impede rational behaviour but also substantially exclude consumer choice (credit crunch, risk-based pricing).
- Complexity of financial products offered on the market, including disguise, and incentives to sell dysfunctional financial products.
- Role of intermediaries (e.g. fees vs. commissions).

The information approach is particularly difficult in the area of financial services which give consumers access to an instrument rather than directly to the object of the desire behind the intended consumer purchase decision (e.g. the object being financed, or being saved for). This lies in the unique nature of financial transactions. Money is unique and necessitates a translation of the original need into the language of the market.<sup>58</sup> Credit can give money but also takes away money. This calculation makes the purchasing decision particularly difficult for consumers because consequences over time need to be taken into account and uncertainty will play a role in the equation.

Whereas regulation is increasingly taking into account various findings from the field of behavioural economics, and the European Commission has itself mandated a report on

<sup>52</sup> U Reifner, *Finanzielle Allgemeinbildung – Bildung als Mittel der Armutsprävention in der Kreditgesellschaft* (Nomos: Baden-Baden 2003) 76. On the concept to capacity, see Bootz and Hartmann, 'Kompetenzentwicklung statt Weiterbildung?'.  
<sup>53</sup> R Kemper, cf footnote 51, p 218.

<sup>54</sup> Cf K Simitis, *Verbraucherschutz. Schlagwort oder Rechtsprinzip?* (Nomos: Baden-Baden 1976) 111; B Biervert and WF Fischer-Winkelmann and R Rock, cf n 50, p 177, 178.

<sup>55</sup> Cf B Biervert, WF Fischer-Winkelmann and R Rock, cf n 50, p 177; WC Whitford, *The Functions of Disclosure Regulation in Consumer Transactions* (Institute for Research on Poverty, University of Wisconsin-Madison 1973) 220 (239).

<sup>56</sup> K Simitis, cf n 54, p 111; B Biervert, WF Fischer-Winkelmann and R Rock, cf n 50, p 155.

<sup>57</sup> K Vahrenkamp, *Verbraucherschutz bei asymmetrischer Information: informationsökonomische Analysen verbraucherpölitischer Maßnahmen* (VVF: München 1991) 37.

<sup>58</sup> The nature of money and related concepts in the money society are covered in detail in the recent publication: Reifner, *Die Geldgesellschaft – aus der Finanzkriselernen* (Wiesbaden: VS-Verlag, 2010).



the subject with regard to retail investor decision-making,<sup>59</sup> it would nevertheless be imprudent to believe that these insights can alone deliver consumer outcomes free of detriment within the information approach.

The substantive approach involves mandatory rules prescribing what is and is not allowed, rather than simply providing a duty to inform the consumer. These are often seen as more intrusive into markets and are therefore criticised by many economists who strongly believe that the free-market mechanism is the only solution to efficient economic outcomes. However, when market failures exist, and systematically repeat themselves irrespective of national cultural and institutional settings, the state must be able to remedy these market failures with the most appropriate tools at its disposal.

As found in the recent EU Study on interest rate restrictions,<sup>60</sup> even policy measures as extreme as 'price controls' can be implemented in such a way as to treat the problematic while limiting the unintended consequences as much as possible.

Both models are necessary. Some areas already testify to the need to incorporate the two distinct approaches. The responsible credit movement for example shows that a two-pronged approach is perhaps best suited for policy makers and legislators.

## 5. Conclusion: Consumer protection in financial supervision

Following the English and American example of supervisory reform after the crisis, and also with regard to the proposals of the French Government report, consumer protection should at least be given a place in financial supervision which is clearly separate and independent from prudential supervision. This is in line with the reservations expressed with regard to the compatibility of the supervision of banks' market behaviour, where professional rules (business conduct), compliance and fair competition are jointly exercised with the supervision of prudential regulations, since legal and informational consumer protection have much in common with these rules.

- Behavioural supervision looks at individual banks and not the system, consumer protection looks at individuals and their interests.
- Stability of a provider is an important goal in prudential supervision but not in consumer protection since bankruptcy can be seen as a healthy threat (and punishment) for suppliers whose behaviour has led to their customers' 'exit' or 'voice' creating either losses or additional cost.
- Keeping bad banks alive distorts the market mechanism to the detriment of consumers, so badly managed banks should not be protected from themselves.
- High profits may be good for healthy banks but may show that consumers have paid too much for services or received too little in the form of quality.

<sup>59</sup> See DG SANCO, 'Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective' (2010) at <[http://ec.europa.eu/consumers/strategy/docs/final\\_report\\_en.pdf](http://ec.europa.eu/consumers/strategy/docs/final_report_en.pdf)>.

<sup>60</sup> See <[http://ec.europa.eu/internal\\_market/finservices-retail/credit/mortgage\\_en.htm#studies](http://ec.europa.eu/internal_market/finservices-retail/credit/mortgage_en.htm#studies)>.

- Prudential supervision prefers a calm environment and for talks between supervisor and financial institution to take place behind closed doors in order to prevent a run on a bank or a mass exit, whereas consumer protection needs public awareness about the misbehaviour of financial suppliers as early as possible in order to warn other consumers, mobilise the exit functions of the market and force suppliers to change.
- Consumer protection is part of civil society, which is based on democratic participation of social organisations, while prudential oversight requires rational and responsible behaviour of state agencies.

There are also a number of other incompatibilities in terms of target group, the necessary skills, the different philosophies and the available enforcement mechanisms and sanctions, which make it difficult for prudential supervisors to take on the tasks of consumer protection.

**Table 4: Conceptual differences between prudential supervision and consumer protection**

	<b>Prudential Supervision</b>	<b>Consumer Protection</b>
<b>Legal</b>	Public/admin. Law	private law
<b>Target</b>	State/Community	Individuals
<b>Purpose</b>	Safety of the System	Personal needs
<b>Enforcement</b>	Administration	Courts (supplemented by administrations)
<b>Protected</b>	Bank	Consumer
<b>Bank failure</b>	Intolerable	Necessary
<b>Sanctions</b>	Fines	Damages (supplemented by fines)
<b>Skills</b>	Bank management and accountancy, legal requirements for tier capital	Consumer law and sociological insight in consumer needs and behaviour
<b>Supervisory culture</b>	Cooperative, behind closed doors	Public, demanding

There is a need to develop an independent Financial Consumer Protection Agency in financial services which brings together the necessary skills for banking and finance with the skills for consumer rights and consumer problems, which is independent from the supplier side. Such a Financial Consumer Protection Agency (FCPA) should exist in every EU Member State and will represent an entity that will be alert to actual and potential consumer problems at the national level. The principles behind the work of these agencies at the EU level and the cooperation between them would be the responsibility of the new European Authorities for the supervision of financial activities. While the European authorities should ensure regular contact exists with the FCPAs, a national agency's preferred model and operating details should be determined by circumstances and priorities at national level. The possibility would remain open to create a European FCPA with time should the situation for consumers of financial services



require such a supranational body, however, there is currently no demonstrated necessity to do so at the present time.

## REVIEWING THE PROTECTION OF THE TOURIST: PASSENGERS' RIGHTS AND PACKAGE TRAVEL ONLY OR A TOURIST SERVICES DIRECTIVE?

*Klaus Tonner*

### 1. Introduction

Two separate policies of the European Union deal with the protection of the tourist as the weaker party to the contract. Whereas package travel is part of consumer policy, passengers' rights are under the regime of transport policy. Lots of shortcomings result from this separation, which are discussed in this chapter. The first is the term of 'consumer'. Contrary to the other parts of the consumer acquis, the Package Travel Directive<sup>1</sup> is not limited to travelling for private purposes, and the passengers' rights regulations do not use the term 'consumer' at all, but 'passenger' instead.

Second, internet bookings are a great challenge for the traditional term of 'package'. It is easy for consumers today to book single components of a tour separate – with the result, that they are no longer under the protection of the Package Travel Directive. There is a need to adapt the scope of the Directive to the challenge of internet bookings.

The Package Travel Directive and the Air Passengers' Rights Regulation<sup>2</sup> are under review of the Commission at present, but the reviews are not coordinated. We will develop in this chapter some ideas how to make the two legal instruments more coherent for the future, if not merge them into one instrument. Finally, a more ambiguous step is suggested: to replace the existing law by a Directive on Tourist Services in general, including, besides packages and transport, services of travel agents and accommodation.

<sup>1</sup> Council Directive 90/314/EEC of 13 June 1990 on Package Travel, Package Holidays and Package Tours [1990] OJ L158/59.

<sup>2</sup> Regulation (EC) No 261/2004 of the European Parliament and of the Council of 11 February 2004 establishing Common Rules on Compensation and Assistance to Passengers in the Event of Denied Boarding and of Cancellation or Long Delay of Flights, and repealing Regulation (EEC) No 295/91 [2004] OJ L46/1.