Private law and private enforcement in the post-crisis EU retail financial regulation

Federico Della Negra

Thesis submitted for assessment with a view to obtaining
the degree of Doctor of Laws of the European University Institute

Florence, 5 September 2017

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Department of Law

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I Federico Della Negra certify that I am the author of the work "Private law and private enforcement in the post-crisis EU retail financial regulation" I have presented for examination for the Ph.D. at the European University Institute. I also certify that this is solely my own original work, other than where I have clearly indicated, in this declaration and in the thesis, that it is the work of others.

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SUMMARY

The thesis examines the role of private law and private enforcement in the post crisis EU retail financial markets.
Whilst private law and private enforcement have been traditionally regarded as 'foreign bodies' in EU financial regulation, the thesis argues that after the global financial crisis, private law and private enforcement, through courts and alternative dispute resolution (ADR) mechanisms, have become essential tools to compensate retail clients against mis-selling and mitigate systemic risk.
To substantiate this argument, the thesis analyzes how the national and EU supervisory authorities, ADRs and courts, in Italy, Spain, France and UK, have interpreted and enforced the EU investor protection regulation (conduct, product and disclosure rules) before and after the global financial crisis.
This institutional and comparative analysis shows that the EU regulatory duties, via regulation, 'administrative rule-making', out-of-court dispute resolution and litigation, increasingly influence the interpretation of national private law (Europeanization) and determine its consequent instrumentalization to achieve a high level of investor protection and ensure the stability of the financial market.
The thesis argues that this form of instrumentalization has led to the creation of private law remedies and procedures which, albeit based on national law, have become tools to ensure the effective protection of the EU-derived rights (hybridization).
After the crisis, the process of hybridization is driven not only by the investor protection objective but also by the financial stability objective which can determine a limitation of the private law law rights and remedies of the investor vis-à-vis the financial firm in order to mitigate the systemic risk, arising, in particular, from vexatious litigation.
The thesis discusses the complex relationship between the investor protection and the financial stability objectives of EU financial regulation and examines the extent financial stability concerns can lead to a limitation of the investors rights and remedies in financial disputes.

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Part I: THE SUBSTANTIVE LEGAL DESIGN OF RETAIL FINANCIAL TRANSACTIONS

Setting the scene

The first Part of the thesis illustrates the research question and methodology of the research and examines the substantive level of governance of retail financial transactions. Chapter 1 begins by explaining the reasons, the objectives (research question), methodology of the research and the structure of the thesis. Chapter 2 sets the scene for the investigation of the impact of EU financial regulation on national private law, by illustrating the objectives, rationales and tools of investor protection regulation before and after the crisis. Chapter 3 discusses the role of private law and private enforcement in EU financial regulation, by examining the regulatory techniques adopted by the EU, before and after the crisis, to influence national private law rights, remedies and procedures.

Chapter 1 – REASONS, OBJECTIVES AND METHODOLOGY OF THE RESEARCH

1. The reasons for the research

1.1. The mis-selling of financial instruments: Direct and indirect negative externalities

The thesis examines the role and functions of private law and private enforcement in the EU retail financial markets. Its main purpose is to understand how private law and private enforcement could reduce the detriment caused by the misconduct of credit and investment firms (hereinafter 'financial firms' or 'firms') for clients and the financial system as a whole.

One of the most recurrent misconduct experienced by Member States in the wake of the global financial crisis[1] is the mis-selling of financial instruments.[2] Mis-selling has been traditionally regarded as a consumer protection-related problem, caused by the firm the firms' mis-conduct 'at the point of sale'. However, mis-selling is often rooted in the firm's business model (i.e. distribution of complex financial products to search for yields) and its inadequate internal governance and organisation processes (i.e. poor practices for internal product's approval). Mis-selling therefore is often the peak of the iceberg of serious prudential deficiencies which could also develop in crisis situations or insolvency. Indeed, since the burst of the global financial crisis, the crisis or insolvency of financial firms in the EU have been often anticipated or signalled by mis-selling of their financial instruments via self-placement[3] or through intermediation.[4]

Hence, the negative effects of mis-selling reach far beyond the losses caused to the firm's client: they concern also other interconnected firms and the financial system as a whole. In particular, mis-selling generates both direct and indirect third-party effects (or negative externalities). Its most important direct externality is the undermining of investor confidence in the financial system which is key to ensure that financial market participants have a "social license — the consent of society to operate and innovate".[5] The indirect externality of mis-selling stems from the regulatory and enforcement reactions triggered by the injured parties and competent authorities. The redress costs of mis-selling, due to civil (damages) or administrative penalties (fines), could erode the solvency and profitability of the defendant firm causing problems, especially if the firm is systematically important, to the stability of the financial system.[6] The redress costs could also affect the safety and soundness of the financial firms that are

[1] The global financial crisis (hereinafter also 'the financial crisis' or 'the crisis') was triggered by the insolvency of Lehman Brothers Holdings Inc. ('LBHI') which entered into administration on 15 September 2008 at 6.56am London time.
[2] 'Mis-selling' indicates the firms' breach of the rules governing the distribution of financial instruments to clients. See also ESRB. *Report on misconduct risk in the banking sector*. June 2015, p. 7.
[3] See the mis-selling of *partecipationes preferentes* in Spain (Chapter 6, below).
[4] See the mis-selling of Lehman Brothers products in the EU (Chapter 6, below).
[5] Bank of England. *Financial Stability Report*. July 2015, p. 28.
[6] Between 2010 and 2015, the redress costs for mis-selling paid to both professional and retail clients by financial firms around the world accounted for more than EUR 100 billion. See ESRB. *Report on misconduct risk in the banking sector*, p. 6.

interconnected by reason of their similar assets, portfolios or business models, creating a spiral of systemic risk that could impact the stability of the financial system.[7]

1.2. Understanding the role of private law and private enforcement in financial markets

It is widely accepted that the regulation and effective enforcement of conduct of business rules are necessary preconditions to ensure a high level of investor confidence.[8] However, the central problem of governing mis-selling is how to ensure that the measures aimed to strengthen the investors' confidence do not create adverse third-party effects (indirect externalities) which could ultimately backfire the investors themselves.

After the crisis, the EU introduced specific measures to increase the protection of retail clients. The MiFID II[9] has strengthened product governance and conduct of business requirements laid down by the MiFID I.[10] In addition, the MiFIR[11] and PRIIPs Regulatio[12] conferred on the newly-established European Supervisory Authorities

[7] There is no common definition of systemic risk and financial stability. For the sake of this study, systemic risk can be defined as "a risk of disruption to financial services that is caused by an impairment of all or parts of the financial system and has the potential to have a serious adverse effect on economic activity" (IMF. *Systemic Risk and the Redesign of Financial Regulation,* 2010). Financial stability can be defined as "the situation where the distinct parts of the financial system are able to perform their functions without major disruptions in the financial system or the economy in general" (K. Tuori, K. Tuori. *The Eurozone Crisis. A Constitutional Analysis*, Cambridge University Press, 2014, p. 58). For an overview of the notions of systemic risk and financial stability, see G. Lo Schiavo. *The Role of Financial Stability in EU Law and Policy*, Alphen aan den Rijn: Wolters Kluwer, 2017, p. 52.

[8] See IOSCO. Mitigating Systemic Risk.A Role for Securities Regulators. February 2011, p. 43; European Parliament. Consumer Protection Aspects of Financial Services. IP/A/IMCO/ST/2013-07 PE 507.463, February 2014, p. 69; ESRB. Report on Misconduct Risks in the Banking Sector, p. 3.

[9] 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 OJ L 173/349 (2014) ("MiFID II").

[10] 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 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC OJ L 114/60 ("MiFID I").

[11] Regulation No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) No 648/2012 OJ L 173/84 (2014) ("MiFIR").

[12] Regulation No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products OJ L 352/1 (2014).

('ESAs')[13] and the National Competent Authorities ('NCAs') incisive powers to restrict the distribution of financial products.

Whilst these EU post-crisis reforms have shifted to the EU level certain supervisory and public enforcement powers, they have not substantially affected the system of private enforcement of conduct of business rules, which remains based on national institutions – courts, alternative dispute resolution (ADR) mechanisms – remedies and procedures. However, in the wake of the financial crisis, national courts and ADRs have been called upon to remedy the losses suffered by retail clients as a result of mis-selling. The high number of mis-selling related disputes brings to light the general problem of the role, objective and function of national private law duties, remedies and procedures in the post-crisis EU retail financial markets. A growing body of scholarly literature has already investigated the relationship between EU investor protection regulation (in particular, conduct of business rules) and national private law by examining the legal nature (public or private law) of conduct of business rules,[14] the goals of conduct of business rules and contract law rules,[15] the modes by which EU conduct of business rules can affect national private law[16] and the different approaches followed by national courts in adjudicating mis-selling disputes.[17]

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[13] The ESAs include the European Securities and Markets Authorities (ESMA), the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA). See Regulation (EU) No 1095/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Securities and Markets Authority) OJ L 331/84 (2010) ('ESMA Regulation'); Regulation (EU) No 1093/2010 of 24 November 2010 establishing a European Supervisory Authority (European Banking Authority) OJ L 331/12 (2010) ('EBA Regulation'); Regulation (EU) No 1094/2010 of the European Parliament and of the Council of 24 November 2010 establishing a European Supervisory Authority (European Insurance and Occupational Pensions Authority) OJ L 331/48 (2010) ('EIOPA Regulation').

[14] See in particular J. Köndgen, 'Rules of Conduct: Further Harmonisation?', in G. Ferrarini (ed), *European Securities Markets: The Investment Services Directive and Beyond* (London / The Hague / Boston: Kluwer Law International, 1998, p. 117 and G. Ferrarini."Contract Standards and the Markets in Financial Instruments Directive (MiFID)" 1 European Review of Contract Law (2005): 21, P. O. Mülbert. 'The Eclipse of Contract Law in the Investment Firm-Client- Relationship: The Impact of the MiFID on the Law of Contract from a German Perspective' in G. Ferrarini and E. Wymeersch (eds.).Investor Protection in Europe: Corporate Law Making, The MiFID and Beyond. Oxford: Oxford University Press, 2006, p. 317

[15] See in particular S. Grundmann. "The Banking Union Translated into (Private Law) Duties: Infrastructure and Rulebook" 16 European Business Organization Law Review (2015): 1;

[16] See in particular O. O. Cherednychenko. "Contract Governance in the EU: Conceptualising the Relationship between Investor Protection Regulation and Private Law" 21 European Law Journal (2015): 500–520.

[17] See in particular O. O. Cherednychenko. 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' 33 Journal of Consumer Policy (2010): 403–424; D.

However, several aspects, which are crucial to better understand the private law-financial regulation relationship, remain underdeveloped. First, whilst literature seems to converge on the claim that the pre-crisis EU conduct of business rules, laid down by the Investment Service Directive ("ISD")[18] and the MiFID I, have increasingly influenced the interpretation and enforcement of national private law,[19] it is unclear how this 'influence' should be conceptualized and how it can be legally justified on the basis of the general principles of EU law.

Second, the existing research has almost exclusively focussed on how national courts can enforce regulatory standards but devoted little attention to the role played by other institutional actors, such as supervisory authorities[20] and especially ADRs, in the enforcement of these standards and how these forms of enforcement can influence the interpretation of general contract law.

Third, legal doctrine has generally looked at mis-selling as a consumer protection problem rather than a wider systemic problem and has therefore discarded the 'paradoxi of private law in financial markets'[21]: whereas private law strengthens the investors' confidence, primarily through its deterrent effect, it can increase the indirect externalities of mis-selling because civil law sanctions, triggered by the initiative of

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Busch. 'Why MiFID matters to private law—the example of MiFID's impact on an asset manager's civil liability' 7 Capital Markets Law Journal (2012): 386-401; J.P. Braithwaite. "OTC derivatives, the courts and regulatory reform" 7 Capital Markets Law Journal (2012): 364; F. Della Negra. 'The private enforcement of the MiFID conduct of business rules. An overview of the Italian and Spanish experiences' 10 European Review of Contract Law (2014): 571; P. Reynolds. 'Selling financial products: the interface between regulatory and common law standards' 29 Journal of International Banking Law and Regulation (2014): 269.

[18] Council Directive 1993/22/EEC of 10 May 1993 on investment services in the securities field OJ L 141/27 (1993) ("ISD").

[19] See in particular D. Busch. "The Private Law Effect of MiFID I and MiFID II" in D. Busch and G. Ferrarini (eds.). Regulation of the EU Financial Markets. MiFID II & MiFIR, Oxford: Oxford University Press, 2017, p. 176; M. Andenas, F. Della Negra. "Between Contract Law and Financial Regulation: towards the Europeanisation of general contract law" European Business Law Review (2017): 499-521.

[20] See on this aspects Y. Svetiev, A. Ottow. 'Financial Supervision in the Interstices Between Private and Public Law' 10 European Review of Contract Law (2014): 496–544; O. O. Cherednychenko. 'Public Supervision over Private Relationships: Towards European Supervision Private Law?' 1 European Review of Private Law (2014): 37–68 and F. Della Negra. 'The Effects of the ESMA's Powers on Domestic Contract Law' in M. Andenas, G. Deipenbrock (eds.). *Regulating and Supervising European Financial Markets*, Springer, 2016, 139-166.

[21] See K. Pistor. 'Legal Theory of Finance' 41 Journal of Comparative Economics (2013): 315 who refers to the paradox of law and finance. However, she does not make a distinction between the impact of different legal instruments (private law and regulation) and institutions (courts, supervisors, ADRs) on financial markets.

private parties acting in their own interest, could weaken the solvency and profitability of financial firms, thus increasing systemic risks.

2. The objectives and the methodology of the research

2.1. The research question

This thesis aims to fill these gaps and to offer a better understanding of how EU investor protection regulation can affect the private law relationship between financial firms and retail clients and the enforcement of their private law duties. The starting hypothesis is that EU conduct of business rules increasingly influence the interpretation and enforcement of private law duties leading to the instrumentalization of private law. This influence can be explained through the concept of hybridization of national private law, namely the gradual instrumentalization of private law duties, remedies and procedures to achieve the objectives of EU investor protection regulation. Legally, the hybridization results from the interpretation of national private law in light of EU law and from the application of the principle of effectiveness and the fundamental right of effective judicial protection to private law disputes.

The main purpose of the thesis is to identify the legal drivers[22] of the 'influence' of the EU post-crisis investor protection reforms on private law and to assess how this influence can be conceptualized and how can be legally motivated and supported on the basis of EU law. The thesis therefore adopts a descriptive approach in that it is mostly concerned with the critical assessment of the implications of the regulatory, enforcement and institutional changes rather than with the evaluation of these regulatory and enforcement options in light of a legal or economic standard. Only the

[22] For the impact of the societal, economic and technological factors on the governance of retail financial transactions, see F. Della Negra. 'The transformation of the retail financial transactions in the EU and the role of contract law', in G. Comparato, H.-W. Micklitz, Y. Svetiev (eds.), European Regulatory Private Law – Autonomy, Competition and Regulation in European Private Law, EUI Department of Law Research Paper No. LAW 2016/06 ERC-ERPL-18.

last part of the thesis will put forward some more normative considerations to explain why the instrumentalization of private law, through the model of hybridization, offers, according to the general principles of EU law and EU fundamental rights, a valuable model to reconcile regulation and autonomy, protection and stability, in the EU retail financial markets.

Having in mind these research's objectives, the research question of the thesis can be formulated as it follows: what are the conceptual and legal implications of the increasing influence of EU investor protection regulation on private law and private enforcement?

This research question can be divided into three sub-questions, which consider three different levels of contract governance: (i) the substantive level; (ii) the enforcement level; and (iii) the institutional level. At the substantive level, the question arises as to if and how the requirements imposed on financial firms by EU investor protection regulation (in particular, conduct of business rules) interact with that of national private law, and whether national private law duties and remedies can be stricter than the EU-derived requirements. This question intersects the broader issue of the interplay beween regulation and autonomy in the EU regulated markets.[23] The autonomy/regulation parameters will be used as theoretical starting points to measure the different techniques adopted by the EU legislator to tighten the EU investor protection requirements as well as to harmonise private law in financial regulation.

At the enforcement level, the key question is if and how the EU, despite its decentralized system of private enforcement, based on national courts and ADRs, can affect the private enforcement of the EU-derived conduct of business rules. To address this question, attention will be paid to the so-called 'horizontality' of EU law; namely,

[23] See, in particular, H.-W. Micklitz, G. Comparato, Y. Svetiev. 'The Regulatory Character of European Private Law', in C. Twigg-Flesner (ed.), Research Handbook on EU Consumer and Contract Law, Cheltenham: Edward Edgar Publishing, 2016, p. 41.

the extent to which provisions formally addressed to Member States and their organs can nevertheless produce effects also between private parties via the general principles of EU law as well as EU fundamental rights.

Finally, at the institutional level, the main question is how the EU and national institutions (legislators, courts, supervisors and ADRs) have evolved after the financial crisis and how these institutions should be better designed to prevent the detriment caused to clients and third-parties by mis-selling. In this regard, attention will be devoted to the changes in the location of regulatory, supervisory and enforcement powers, in particular, from the national to the EU level, and from *ex post* (e.g. litigation) to *ex ante* (product intervention) mechanisms of contract governance (see Fig. 1).[24]

Fig. 1: The institutional mechanisms for the governance of financial transactions

EU/national law	**Public**	**Private**	**Enforcement tools**
Ex ante	Regulation, product intervention	Contracts	Rights (and remedies[25])
Ex post	Sanctions	Litigation	(Remedies and) procedures[26]

2.2 The methodology and scope of the research

To address these research questions, the thesis adopts an institutional and comparative methodology which builds on the theoretical insights of contract governance research and the European Regulatory Private Law ('ERPL') project.

[24] See also section 2.2.1, below.
[25] Whilst from a rule-making perspective, remedies and procedures are *ex ante* tools, because they are based on rules, from the parties'perspective they are *ex post* tools because they become operational only after the breach of the rule.
[26] On the definition of remedial and procedural rules see section 2.2.1., below.

2.2.1 Neo-institutionalism and contract governance research

The thesis draws on the insights from neo-institutional legal theories, and, in particular, contract governance research.[27] After the financial crisis, neo-institutional economic theories have underlined, in contrast with mainstream economic theories, that the human decision-making is not a rational process but is driven by cognitive limitations and bounded rationality. Additionally, these approaches contend that information asymmetries and imperfections are not just a market failure but are inherent to the modern financial markets, characterized by irreducible uncertainty and not mathematically-modellable risks.[28]

Neo-institutionalist economics have also influenced legal discourse, leading to the development of a strand of neo-institutionalist legal research. This research has underlined the need to shift from the neo-classical conception of markets as *loci naturalis*, in which legal structures are exogenous and determined by the micro-individual economic relationships, to the conception of markets are *loci artificialis,* in which legal structures are endogenous to micro-economic relationships and can drive them th to achieve socially desirable goals, such as the protection of clients and the stability of the financial system.[29] These legal structures are included in the North's concept of 'institutions'[30] namely "the humanly devised constraints, created either by individuals or organisations, that structure political, economic and social interaction in

[27] For an overview of the variants of neo-institutionalism see J. Black, "Seeing, Knowing, and Regulating Financial Markets: Moving the Cognitive Framework from the Economic to the Social", LSE Law, Society and Economy Working Papers 24/2013 London School of Economics and Political Science Law Department.

[28] See A. Turner. *Economics after the crisis. Objectives and means*. Cambridge. Massachussets: , MiT press,2012, 44.

[29] See S. Deakin. 'The legal theory of finance: Implications for methodology and empirical research' 41 Journal of Comparative Economics (2013): 339.

[30] See in particular J. Armour, S. Deakin, V. Mollica, M. Siems. "Law and Financial Development: What We Are Learning from Time-Series Evidence" Brigham Young University Law Review 2009/6, p. 1435; K. Pistor. "Legal Theory of Finance" 315.; J. Black.'Seeing, Knowing, and Regulating Financial Markets: Moving the Cognitive Framework from the Economic to the Social', 5.

order to reduce uncertainty in exchange".[31] This institutionalist approach was first applied to the governance of organizations and corporations (corporate governance)[32] and more recently to the governance of contracts (contract governance).[33]
The contract governance research offers an indispensable theoretical toolbox to analyze the complex interactions between EU investor protection and private law for the following reasons.

First, contract governance looks at contracts not only as mechanisms to exchange goods and services but also as organizational arrangements to regulate the risks involved in long term transactions, such as the interdependence between the parties' performance, investment-specificity and fundamental uncertainty. Financial transactions are indeed typically (self-) regulated by long-term contracts, characterized by various levels of interdependence, depending on the type of financial service,[34] and different levels of specificity and uncertainty depending on the nature of the financial instrument involved.[35] The thesis will therefore focus on intermediated transactions and on its most important EU regulatory tools (the ISD, the MiFID I and the MiFID II). Limited amount of attention will be given to the non-intermediated transactions, namely the financial transactions in which financial firms act as principal or contractual counterparty to the client without offering a service (i.e. dealing in their own account).[36]

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[31] D. C. North. "Institutions" 5 *The Journal of Economic Perspectives* (1991): 97-112.
[32] O. Williamson. "Transaction-Cost Economics: The Governance of Contractual Relations" 22 Journal of Law and Economics (1979): 233.
[33] See in particular F. Möslein, K. Riesenhuber. "Contract Governance – A Draft Research Agenda" 3 European Review of Contract Law (2009): 248-289 and S. Grundmann, F. Moslein, K. Riesenhuber (eds.). *Contract Governance. Dimensions in Law and Interdisciplinary Research*, Oxford: Oxford University Press, 2015.
[34] The interdependence ranges from a low level in execution-only transactions, to higher levels of in investment advice and porfolio management services
[35] Investment specificity is higher for illiquid than liquid instruments and uncertainty is higher for complex instruments which make the return dependent on the performance of another instrument or which are designed in a way that may not provide for a full repayment of the principal amount than for non-complex instruments which provide for a fixed return.
[36] See for the distinction between intermediated and non-intermediated transactions D. Busch. 'Agency and Principal Dealing under MiFID I and MiFID II' in D. Busch and G. Ferrarini (eds.). Regulation of the EU Financial Markets. MiFID II & MiFIR, p. 227.

Second, contract governance departs from the traditional distinction between public and private law and considers contract law and regulation as regulatory layers of the composite "institutional framework within which the integrity of a transaction is decided".[37] Such an institutional framework indeed includes a variety of externally imposed regulatory regimes (like private law, prudential, conduct, product requirements) as well as self-regulatory regimes (like standards contract terms), and mixed regimes (like co-regulation).

Third, contract governance undertakes a functional approach to regulation, centred on the function played by the institutions in the market place. In this respect, a crucial difference is between *ex ante* or *ex post* interventions.[38] Whilst *ex ante* mechanisms (contracts, regulation, precautionary product intervention powers) give prominence to the "proactive institutions", (e.g. rule-makers and supervisory authorities) and their capacity to consider the wider systemic implications of the transaction, the *ex post* mechanisms *post* (administrative sanctions, litigation and dispute resolution) give prominence to the "reactive institutions" (e.g. courts and ADRs) and to their capacity to compensate wrongs suffered by the client.[39] To underscore the importance of the *ex ante*/*ex post* difference, the thesis follows a three-tiered approach[40] by looking at: (i) the substantive level of governance namely the rules (regulatory, contractual and

[37] O. Williamson. 'Transaction-Cost Economics: The Governance of Contractual Relations', 235 and F. Möslein, K. Riesenhuber. 'Contract Governance' 265. who identify four modes of contract governance: 'governance of contract law'; 'governance of contracts'; 'governance by means of con- tract law'; 'governance through contract'.

[38] See in particular F. Möslein, K. Riesenhuber. 'Contract Governance', 264. In this study, the distinction between *ex ante* and *ex post* takes as a point of reference the occurrence of a loss caused by the firms' mis-conducts. In more detail, for this distinction, S. Issacharoff, I. J. Samuel. "The Institutional Dimension of Consumer Protection", in F. Cafaggi, H.-W. Micklitz (eds.), New Frontiers of of Consumer Protection: Combining Private and Public Enforcement, Antwerp: Intersentia, 2009, p. 4.

[39] For the difference between practive and reactive institution see Chenggang Xu, Katharina Pistor. "Law Enforcement under Incomplete Law: Theory and Evidence from Financial Market Regulation" Columbia Law School The Center for Law and Economic Studies Working Paper No. 222/2003.

[40] See H.-W. Micklitz. 'Herd Behaviour and Third Party Impact as a Legal Concept. On Tulips, Pyramid Games, and Asset backed Securities' in S. Grundmann, F. Möslein, K. Riesenhuber (eds.), "Contract Governance", 133. See also for a similar classification P. Zumbasen. "'Inside' and 'Outside' the Firm: Corporate Law and Contract Governance as Regulatory Theories", in Lomfeld B., Somma A., Zumbansen P. (eds.). *Reshaping Markets. Economic Governance, the Global Financial Crisis and Liberal Utopia*, Cambridge: Cambridge University Press, 2016, p. 71.

contract law)[41] conferring rights and/or imposing duties on the market participants; (ii) the enforcement level namely the rules imposing negative consequences on the violators of the substantive rules (remedial rules[42] or primary enforcement rules) and the rules, addressed to other people than the wrongdoer (e.g. courts, ADR bodies and supervisory authorities), governing how substantive and remedial rules should be applied (procedural or secondary enforcement rules)[43]; and (iii) the institutional level; namely, the legal mechanisms (*ex ante*, *ex post*; EU and national) which set the substantive and procedural rules.

Fourth, contract governance takes into account both the traditional 'internal' dimension of the financial transaction, focussed on the parties' rights and obligations, and the 'external' dimension of financial transactions,[44] which is concerned with the third-party effects (or negative externalities) arising from the transaction. The thesis considers the potential third-party effects deriving from the misconduct, insolvency or resolution[45] of the financial firm or from the acts adopted by regulators, supervisors or adjudicators to remedy misconduct.[46] The thesis, however, considers only the third-party effects with systemic implications, such as in particular, those deriving from the resolution or insolvency of systematically important financial firms[47], since this kind of third-party effect can transform individual or transactional risks, into collective or

[41] Contract law and contractual instruments tend to coincide when contract law sets mandatory rules, whilst they may diverge in the case of default rules. See, in this regard, F. Möslein, K. Riesenhuber. 'Contract Governance' 284.

[42] The location of remedies in the *ex ante* and *ex post* classification is controversial: whilst they are set *ex ante* by regulators, their functioning is strongly influenced by the interpretation of judges and ADRs *ex post*.

[43] See for this notion of remedies and procedures O. A. Hathaway and S. J. Shapiro. 'Outcasting: Enforcement in Domestic and International Law' 121 The Yale Law Journal (2011): 271.

[44] See S. Grundmann, F. Möslein, K. Riesenhuber Contract Governance: Dimensions in Law and Interdisciplinary Research in S. Grundmann, F. Möslein, K. Riesenhuber (eds.). Contract Governance: Dimensions in Law and Interdisciplinary Research, p. 42.

[45] See Article 32(1)(a) of the Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms ("BRRD") OJ L 173/249 (2014).

[46] See F. Möslein. "Third Parties in the European Banking Union: Regulatory and Supervisory Effects on Private Law Relationships Between Banks and their Clients or Creditors" 16 European Business Law Review Rev (2015):547–574.

[47] For the criteria to define systematically important credit institutions, see the recital No 9 of the ESRB Regulation.

societal risks.[48] A key theme of the thesis is how private law and private enforcement can be designed in order to mitigate systemic risks. In fact, whilst generally speaking the respect of contract promises enhances the legal and commercial certainty – and therefore could be seen as a factor stabilizing financial markets, the principle of *pacta sunt servanda* can also lead to increase systemic risk, for example by allowing firms to enforce contracts that might trigger a cascade of insolvencies, or by leading self-interested investors to bring lawsuits which could deplete the assets of competing financial firms.[49]

2.2.2. The European Regulatory Private Law (ERPL) project

The thesis draws important insights also from the the theoretical foundations and methodology developed by the research project ERPL led at the European University Institute by Professor Hans-W. Micklitz.[50]

The core hypothesis of the ERPL project is that the EU has built up a 'self-sufficient' body of European regulatory private law, composed of its own substantive and enforcement mechanisms, and driven by "economization" and "politicization". The scope of the ERPL is broader than classical contract and tort law because it includes all the legal instruments which, irrespective of their private or public nature, govern the internal market (economic law). The ERPL, unlike traditional private law, centred on the notion of private autonomy and commutative justice, is based on the notion of regulated autonomy and 'access justice' (*Zugangsgerechtigkeit*). The oxymoric concept of "regulated autonomy" indicates that the autonomy of market actors is, at the same

[48] See, in particular, H.-W. Micklitz. 'Herd Behaviour and Third Party Impact as a Legal Concept. On Tulips, Pyramid Games, and Asset backed Securities' in S. Grundmann, F. Möslein, K. Riesenhuber (eds.). Contract Governance, p. 112.

[49] See K. Pistor. 'LegalTheory of Finance', 315. See also H.-W. Micklitz, G. Comparato, Y. Svetiev. 'The Regulatory Character of European Private Law', in C. Twigg-Flesner (ed.). *Research Handbook on EU Consumer and Contract Law*, p. 63.

[50] The ERPL project ran from October 2011 to August 2016 (https://blogs.eui.eu/erc-erpl/project-description/#anchor_8). For the theorization of ERPL, see, in particular, H.-W. Micklitz. "The Visible Hand of European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation" 28 Yearbook of European Law (2009): 3-59; H.-W. Micklitz, G. Comparato, Y. Svetiev. "The regulatory character of European private law in C. Twigg-Flesner (ed.), Research Handbook on EU Consumer and Contract Law, p. 36.

time, limited to ensure that the weaker contractual parties can effectively access these markets, and extended, to ensure that the barriers to competition are removed.[51] This model of autonomy is functional to achieve access justice, whereby justice "lies somewhere between social distributive and libertarian allocative justice [and builds upon] 'access rights' and 'anti-discrimination'".'[52]

The importance and significance of the ERPL project for this thesis is threefold. First, through the concept of regulated autonomy, the ERPL project offers a theoretical framework to analyse the reciprocal interactions between autonomy and regulation, two concepts that are traditionally separated by private lawyers and regulatory lawyers. Such interactions – it is submitted – should in fact be explored, irrespective of the formal or dogmatic qualification of the source of the norm (private or public law), but by looking at the concrete function pursued by the that norm (e.g. client protection).

Second, the ERPL project is important because it posits that the ERPL, as a self-sufficient body of EU law, whilst part of EU sector-specific (or silo-based) rules, principles and enforcement mechanisms,[53] does not stand in isolation from national private laws but constantly interacts with them, through several patterns or normative models of interaction: intrusion and substitution, conflict and resistance, hybridization and convergence.[54] These interactions take place not only through the formal, top-down EU legislation but also through the spill-overs of the EU administrative and judicial acts adopted to implement EU law. This methodology will serve as a tool to

[51] See in particular G. Comparato and H.-W. Micklitz. "Regulated Autonomy Between MarketFreedoms and Fundamental Rights in the Case Law of the CJEU", in U. Bernitz, X. Groussot and F. Schulyok (eds). *General Principles of EU Law and European Private Law*, Alphen aan den Rijn: Kluwer, 2013; N. Reich. *General Principles of EU Civil Law*, Cambridge: Intersentia: 20.

[52] H.-W. Micklitz. '*Social Justice and Access Justice in Private Law*' EUI Working Papers LAW 2011/02 DEPARTMENT OF LAW. See also M. W. Hesselink. "Contract theory and EU contract law" in Christian Twigg-Flesner (ed.), Research Handbook on EU Consumer and Contract Law, Cheltenham: Edward Elgar, 2016, p. 531.

[53] See in particular, H.-W. Micklitz and Y. Svetiev. "The transformation(s) of private law" in H-W Micklitz, Y Svetiev and G Comparato (eds), *European Regulatory Private Law – The Paradigms Tested*, EUI Working papers, LAW 2014/04, 69–97, 78.

[54] H.-W. Micklitz. 'The Visible Hand of European Regulatory Private Law—The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation', 3.

measure the impact of EU conduct of business rules on national legislation and enforcement and to understand how the interaction between these two legal formants can be better explained and conceptualized.

Third, the ERPL project recognizes, following an institutional approach, that national private law, in regulated markets, can be influenced not only by traditional law making (legislation) and enforcement (courts) mechanisms but also and more frequently by forms of quasi-regulation (i.e. soft law via agencies) and hybrid enforcement (i.e. adjudication via ADRs),[55] which have gained a very important role in post-crisis EU retail markets.

2.2.3. The comparative approach

Given that national private law and enforcement mechanisms are largely based on national law, it is of vital importance to understand how different institutions in the different Member States have interpreted the relationship between financial regulation and contract law. To this end, the thesis complements the previously mentioned institutional approach with a comparative approach which seeks to identify convergent and divergent trends in the way national supervisory authorities, ADRs and courts enforce and ensure the effectiveness of the EU investor protection rules.

The comparative analysis comprises Italy, Spain, France and the UK. The selection of these jurisdictions is based on two main reasons. First, over the past two decades these jurisdictions have experienced large scale mis-selling cases related to criminal fraud – in Italy, Cirio (2002) and Parmalat (2004); in France, Vivendi (2002) – or banking crisis – in Spain, Bankia, NGC Banco, Catalunia Caxia (2012); in the UK, Northern Rock (2008) – which have provoked serious losses to thousands of investors and triggered important regulatory reforms. In addition to this, Italy, France, Spain and UK are

[55] H.-W. Micklitz. 'The Transformation of Enforcement in European Private Law: Preliminary Considerations' 4 European Review of Private Law (2015): 491–524.

among the six European countries that account for almost two thirds of the entire European market for structured financial products.[56]

As a final note, on 29 March 2017 the UK notified to the European Council its intention to withdraw from the European Union, in accordance with Article 50(2) of the TEU, as a result of the referendum of 23 June 2016 ('Brexit referendum'). The withdrawal of the UK from the EU raises critical legal and political issues with particular regard to the EU financial markets.[57] This thesis, however, will not consider the implications of the withdrawal for the research question.

3. Structure of the research

The thesis is divided in three Parts and comprises nine Chapters. The first Part analyses the substantive level governance of the retail financial transactions, i.e. their multi-layered regulatory regime composed by financial regulation and private law. Chapter 2 sets the scene for the investigation of the impact of EU financial regulation on national private law, by illustrating the objectives, rationales and tools of investor protection regulation before and after the crisis. It devotes particular attention to the evolution of the EU regime for conduct of business rules (from the ISD, to the MiFID I and the MiFID II) since these rules are the most important EU regulatory tool to govern firm–client relationships and the most litigated rules before national courts and adjudicators in mis-selling disputes. Chapter 3 introduces a discussion on the role of private law and private enforcement in EU financial regulation. After analysing the conceptual distinctions between autonomy-driven and regulatory-driven private law and illustrating the objectives of private enforcement in finance (compensation, deterrence and financial stability), it considers the regulatory techniques adopted by the EU, before and after the crisis, to influence national private law rights, remedies and procedures. This analysis shows, in line with already emerged trend in EU investor

[56] See ESMA. *Economic Report. Retailisation in the EU*, ESMA/2013/326, p. 16.

[57] For an overview, see C. V. Gortsos. 'Potential Concepts for the Future EU- UK Relationship in Financial Services', Study for the ECON Committee of the European Parliament. IP/A/ECON/2016-20 PE 595.335. January 2017.

protection regulation, that whilst before the crisis the EU had only conferred rights on investors, leaving Member States free to establish the contractual consequences of their breach, after the crisis the EU has also introduced harmonized remedies to increase the protection of clients and ensure the stability of the financial system.

The second Part of the thesis examines the procedural level of governance of retail financial transactions in the EU. To this purpose, it focusses on how supervisory authorities, alternative dispute resolution (ADR) mechanisms, and national courts, in Italy, Spain, France and the UK, have enforced, or ensured the effectiveness of EU investor protection regulation (in particular, conduct of business rules) before and after the crisis. Chapter 4 begins by discussing the role played by ESMA and national supervisory authorities in regulating and supervising retail markets and underscores the growing intrusiveness of supervision in private law relationships, namely through the governance of financial products, the formalization of supervisory standards and the consequent standardisation effects of contract terms.

Chapter 5 discusses the important role played by ADR mechanism in the resolution of retail client disputes. It brings to light a general trend towards the de-judicialisation of retail disputes (i.e. migration of disputes out-of-court) and the transformation of ADR from informal dispute resolution mechanisms into quasi-judicial or quasi-supervisory mechanisms to ensure the effectiveness of EU conduct of business rules.

Chapter 6 illustrates how the EU conduct of business rules have affected the interpretation of national private law in financial litigation. To this end, it considers whether national courts may impose stricter private law duties or remedies on the financial firm and what type of remedy is granted to the investor (e.g. compensation or restitutionary remedies). This chapter reveals the divergent approaches between continental courts, which have generally imposed on financial firms' stricter duties of care than that established in financial regulation and, despite the absence of an express private law remedy, have conferred on clients remedies based on general private law

and common law courts, which have generally excluded that the firm's breach of conduct of business rules can give rise to a remedy based on general common law.

The third Part of the thesis examines the conceptual and legal implications of the foregoing substantive and procedural-related analyses, namely the 'Europeanization' and 'instrumentalization' of national private law and enforcement. To demonstrate this argument, the Chapter 7 identifies, on the basis of the earlier findings, the conceptual models of interaction between EU investor protection regulation (separation, substitution and hybridization) and argues that the model of hybridization better reflects the level and nature of the interactions emerged after the financial crisis between EU finacial regulation and national private law. Chapter 8 seeks to determine the EU legal foundations of the model of hybridization and explains why this conceptual paradigm can be legitimized in light of the principle of effectiveness, the principle of effective judicial protection and the EU fundamental rights enshrined in the Charter of Fundamental Rights ('CFR'). Finally, Chapter 9 brings together the main themes of the research and draws the main institutional implications of the instrumentalization of national private law.

Chapter 2 – THE EVOLUTION OF EU RETAIL CLIENT REGULATION

1. The objectives of EU retail client regulation

1.1. Investor protection and market integration

Traditionally, the regulation of financial markets (banking and securities markets) has sought to ensure the safety and soundness of financial firms through capital, liquidity, and solvency requirements (micro-prudential regulation), the stability of the financial system through counter-cyclical capital requirements (macro-prudential regulation), and a high level of client protection through disclosure, distribution, and product regulation rules (client protection regulation).[58]

In the EU, these traditional objectives have been regarded, ever since the 1966 Segré Report,[59] as intermediate objectives to strengthen the functioning of the internal market and therefore to justify the adoption of legislative measures, based on Article 114 of the TFEU (ex Article 95 of the TCE) aimed at harmonizing national laws.[60] In the landmark decision *Alpine Investment BV*, the CJEU made the connection between client protection, client's confidence and market integration clear:

"the smooth operation of financial markets is largely contingent on the confidence they inspire in investors [… and] that confidence depends in particular on the existence of professional regulations serving to ensure the competence and trust worthiness of the financial intermediaries on whom investors are particularly reliant".[61]

Before the global financial crisis, the EU retail investor protection objective was pursued through two different and intertwined regulatory strategies, namely the 'empowering investor' and the 'protecting investor' strategy.[62] After the crisis, also

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[58] See, in particular, C. Goodhart, P. Hartman, D. T. Llewellyn, L. Rojas-Suarez, S. Weisbrod. *Financial Regulation: Why, How and Where Now?, London and New York:* Routledge, 1998, p. 4.

[59] C. Segre. "*The development of a European capital market. Report of a Group of Experts appointed by the EEC Commission". November 1966.*

[60] See in particular N. Moloney. *EU Securities and Financial Markets Regulation.Third Edition*. Oxford: Oxford University Press, 2014, p. 27-28; N. Moloney. "Financial Markets Regulation", in D. Chalmers and A. Arnull (eds.), The Oxford Handbook of European Union Law, Oxford: Oxford University Press, 2015, p. 764 and E. Avgouleas, D. W. Arner. "The Eurozone Debt Crisis and the European Banking Union: 'Hard Choices', 'Intolerable Dilemmas', and the Question of Sovereignty", 50 The International Lawyer (2017): 33.

[61] Case C-384/93, *Alpine Investments BV v Minister van Financiën,* ECLI:EU:C:1995:126, para 42.

[62] See in more detail on this distinction, N. Moloney. 'Regulating the Retail Markets' in N. Moloney, E.

the financial stability-related concerns have played a significant role in shaping retail market regulation objectives and tools determing – it is argued – the rise of a new "financial stability" strategy.

1.2. The 'empowering investor' strategy

The 'empowering investor' strategy conceives retail market regulation as one of the tools, together with credit, insurance and payment regulations, to foster access for all the EU citizens to financial markets.[63] Access to markets is the pre-condition to increase the efficiency of the financial markets[64] and to finance services (e.g. education, retirement planning, and infrastructure building) that are now increasingly supplied by private parties rather than the welfare state.[65] This strategy, which has been pursued by the Commission before[66] and after[67] the financial crisis, particularly in the context of the Capital Markets Union ('CMU')[68], builds on the model of the retail client as an well informed and responsible investor and financial citizen[69] and is mainly reflected in disclosure rules and financial education policies.

1.3. The 'protecting investor' strategy

Ferran, J. Payne (eds.).*The Oxford Handbook of Financial Regulation*, Oxford: Oxford University Press, 2014, p. 739.

[63] See V. Mak. 'Financial services and consumer protection', in C. Twigg-Flesner (ed.), Research Handbook on EU Consumer and Contract Law, p. 317.
[64] See in particular F. H. Easterbrook, D. R. Fischel. 'Optimal Damages in Securities Cases' 52 University of Chicago Law Review (1985): 613.
[65] Special Eurobarometer survey 373 Retail Financial Services. March 2012, p. 28 and thereafter (http://ec.europa.eu/internal_market/finservices-retail/docs/policy/eb_special_373-report_en.pdf)
[66] European Commission. Green Paper on Retail Financial Services in the Single Market. Brussels, 30.4.2007 COM(2007) 226 final.
[67] European Commission. Green Paper on retail financial services. Better products, more choice, and greater opportunities for consumers and businesses. Brussels, 10.12.2015 COM(2015) 630 final and Consumer Financial Services Action Plan: Better Products, More Choice. Brussels, 23.3.2017 COM(2017) 139 final.

[68] European Commission. Green Paper on Building a Capital Markets Union. Brussels, 18.2.2015 COM(2015) 63 final.
[69] Opinion of Attorney-General Jääskinen, in case C-312/14, *Banif Plus Bank Zrt. V Márton Lantos*, ECLI:EU:C:2015:621, para 37 (see also below chapter 8).

In parallel to the 'empowering investor' strategy, the EU has developed, particularly after the crisis, a 'protecting investor' strategy which aims to reduce the risks connected to the financial instruments and is reflected in more intrusive and *lato sensu* precautionary tools (i.e. distribution, product governance and product intervention rules).[70] This strategy considers the retail client as a vulnerable consumer who is "most in need of protection" (recital No 105 of the MiFID II). The ESMA recently recommended that, in relation to firms' investment advice and portfolio management services, "more in-depth information would usually need to be collected for older and potentially vulnerable clients asking for investment advice services for the first time".[71] Notably, in retail financial transactions, the vulnerability derives not only from personal, economic and social factorsbut also from cognitive limitations,[72] in particular cognitive capacity, and bounded rationality or behavioural biases (i.e. financial ignorance, over-confidence, present-bias, susceptibility to persuasion, herding), which can also affect more sophisticated clients.[73]

These two retail market regulation strategies co-exist and complement each other: access to financial markets can be effective only if adequate protection is given to the clients who are most in need of protection. For this reason, the competent authorities can deploy the most intrusive protecting investors tools, such as product intervention powers, only when there is an enhanced need for protection that cannot be addressed with other regulatory tools (distribution regulation).[74] However, there is also a conflictual dimension between these two regulatory strategies. Whilst the 'empowering investor' strategy aims at retaining risk to increase returns and, ultimately, financing services of general economic interest, the 'protecting investor' strategy, which, after the crisis has transformed the client

[70] See N. Moloney. "Regulating the Retail Markets" in N. Moloney, E. Ferran, J. Payne (eds.), *The Oxford Handbook of Financial Regulation*, p. 741 seq.
[71] ESMA, MiFID guidelines on suitability requirements, para 34.
[72] For more detail on cognitive limitations, see S. Grundmann, P. Hacker. "Conflicts of Interest" in D. Busch and G. Ferrarini (eds.), Regulation of the EU Financial Markets, p. 176.
[73] See I. Domurath, G. Comparato and H.-W. Micklitz (eds.),*The Over-indebtedness of European Consumers – a View from Six Countries*, LAW 2014/10 Department of Law European Regulatory Private Law Project (ERC-ERPL - 08) European Research Council (ERC) Grant. For an overview of the types of vulnerabilities, see European Commission, Consumer vulnerability across key markets in the European Union. Final report. January 2016, p. 335 ss.
[74] See section 2.3., below.

into a consumer,[75] leads to the reduction of risks to ensure protection.[76]

1.4. The 'financial stability' strategy

After the global financial crisis, the EU retail client regulation have been "infused with wider financial stability concerns".[77] EU secondary law conceives the stability of financial firms and the stability of the financial system as pre-requisites to ensure the effective access of the citizen to financial services and, ultimately, to foster the integration between national financial markets.[78] Some evidence indeed shows that investor protection and financial stability are, in general, mutually reinforcing:[79] a stable financial markets ensures investors' confidence, specifically because systemic risk (i.e. failure or crisis of a credit institution, over-indebtedness of groups of consumers) reduces the volume of transactions and negatively affects the financial system and society;[80] conversely, 'consumer confidence and trust promotes financial stability, growth, efficiency and innovation over the long term.'[81] On the basis of these premises, as I will show below, the EU introduced some regulatory tools (i.e. product governance and product intervention) with the dual purpose to protect retail client and to safeguard the financial stability and introduced in typical client protection tools (i.e. conduct of business rules) infused with a new financial stability rationale.[82]

However, there are also potential conflicts between investors' confidence and financial stability. For example, the need of ensuring safer financial firms could lead regulators and supervisors to incentivize the distribution of hybrid and complex financial instruments capital instruments (e.g. Contingent convertible capital

[75] See N. Moloney. 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?' 13 European Business Organization Law Review (2012): 169-193.
[76] See D. Kingsford Smith and O. Dixon. 'The Consumer Interest and the Financial Markets' in N. Moloney, E. Ferran, J. Payne (eds.), *The Oxford Handbook of Financial Regulation*, p. 698.
[77] M. Andenas, I. Chiu. *The Foundations and Future of Financial Regulation: Governance for Responsibility,* p. 136 and G. Comparato. "The rationales of financial inclusion in the changing European private law", 11 European Review of Contract Law (2015): 39.
[78] See the recital No 1 of the ESRB Regulation. See also European Commission. European Financial Stability and Integration Review (EFSIR). Brussels, SWD (2017) 171 final, p. 104.
[79] For the connection between client protection and financial stability regulation, see P. O. Mulbert. "Managing Risks in the Financial Systems", in N. Moloney, E. Ferran J. Payne (eds.). *The Oxford Handbook of Financial Regulation*, 367.
[80] See in particular, ESRB, *Report on misconduct risk in the banking sector*, June 2015, p. 4.
[81] OECD. G20 High-level Principles on Financial Consumer Protection, October 2011, p. 4.
[82] See section 3 below.

instruments or CoCos) which present high risks for retail unsophisticated clients.[83] Moreover, civil and administrative law sanctions aimed to enhance the effective protection of investors could weaken the solvency and profitability of the defendant financial firms thus creating risks for the stability of the financial system.

2. The investor protection tools

EU law contains three main tools to protect clients: disclosure rules, distribution rules, and product rules.[84]

2.1. Disclosure: From the UCITS Directive to the PRIIPs Regulation

In EU law, mandatory disclosure requirements are the most important instrument to ensure the efficient functioning of financial markets. Disclosure rules are indeed based on the assumption that the investor is a reasonable person, capable of taking investment decisions by him or herself. However, behavioural biases and cognitive limitations often prevent retail clients from making informed decisions.[85]

This criticism led to the strengthening of the 'simplified' disclosure regimes (in UCITS and PRIIPs) and, as I will show later on, to the reinforcement of distribution and product rules. The most important disclosure tools designed to protect clients is the key information document ('KID'). The KID, introduced by the UCITS IV Directive, has been extended by the PRIIPs Regulation to all packaged retail investment products and insurance-based investment products ('PRIIPs'), which are targeted at retail investors.[86] The main rationale of this regulation is to create a level playing field between the existing disclosure regimes established at the national level for retail investors in PRIIPs (recital No 3).

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[83] ESMA, *Potential Risks Associated with Investing in Contingent Convertible Instruments*. 31 July 2014 ESMA/2014/944.
[84] See, in more detail, N. Moloney. "Regulating the Retail Markets", in N. Moloney, E. Ferran and J. Payne (eds.). The Oxford Handbook of Financial Regulation, p. 736.
[85] See, in particular, FCA. "Applying behavioural economics at the Financial Conduct Authority". April 2013 and J. Y. Campbell, H. E. Jackson, B. C. Madrian, P. Tufano. "Consumer Financial Protection" 25 Journal of Economic Perspectives (2011): 91-114.
[86] See A.Godwin, I. Ramsay. 'Financial products and short-form disclosure documents: a comparative analysis of six jurisdictions' 10 Capital Markets Law Journal (2015): 217.

To this end, the Regulation requires any entity that issues and distributed PRIIPs (including fund managers, insurance companies, banks and investment firms) to draw up a KID specifying important product-related information. Unlike the UCITS KID,[87] the PRIIPs one targets retail investors only. The form and content of the KID reflects the retail-oriented focus of the PRIIPs. The information shall be conveyed through of series of questions and answers regarding essential structural, risk and performance-related elements of the PRIIPs.[88] The KID is expressly defined as 'pre-contractual information' probably to avoid the risk that its infringement leads to a claim for breach of contract.[89] The PRIIP can nevertheless be regarded as a form of product regulation since, as suggested by the OECD, its information concerns 'material aspects of the financial product'[90] and shall be communicated to investors notwithstanding of the service provided by the firm distributing the PRIIP (e.g. portfolio management, advice, execution order).[91]

2.2. Distribution: From the ISD to the MiFID II

Distribution rules are the central element of the conduct of business regulation. Whereas disclosure rules operate mainly on primary markets, distribution rules operate on secondary markets where there is a higher level of interaction and interdependence between the firm and the client.[92] The EU distribution regime has developed through three main regulatory measures: the ISD, the MiFID I and the MiFID II.

2.2.1. The ISD

The ISD was adopted in 1993 to strengthen the functioning of the internal market through the 'single passport', and to increase the protection of clients through a new regime of 'rules of conduct', which investment firms shall observe at all times,

[87] Article 78 of the UCITS IV Directive.
[88] Article 8 (3).
[89] Article 6 (1) of the PRIIPS Regulation and Article 79 (1) of the UCITS V Directive.
[90] OECD, G20 High-level Principles on Financial Consumer Protection, October 2011, p. 6.
[91] Article 25, (4) a MiFID II.
[92] See S. Grundmann, W. Kerber. 'Information Intermediaries and Party Autonomy', in S. Grundmann, W. Kerber, S.Weatherill (eds.). *Party Autonomy and the Role of Information in the Internal Market,* Berlin: Walter de Gruyter, 2001, p. 290.

irrespective of the service provided and the financial instrument distributed by the firm (Article 11).[93] The ISD embedded these rules into seven principles that Member States shall implement taking into account the professional nature of the person for whom the service is provided.[94] However, whereas the ISD's prudential rules (i.e. authorization) were subject to the country of origin principle, the conduct of business rules remained subject to the host country principle (Article 11(2)) with the effect that several different set of rules could apply to a service provided abroad. [95]

2.2.2. The MiFID I

The MiFID I, which was adopted on the basis of Article 47(2) TEC, has the main objective of "creating an integrated financial market, in which investors are effectively protected and the efficiency and integrity of the overall market are safeguarded" (recital No 71).[96] The MiFID I was supplemented by the Commission Directive 2006/73/EC which implements organizational and conduct requirements and the Commission Regulation 1287/2006/EC which details rules for the MiFID secondary markets regime.[97]

With the MiFID I the protection of investors becomes, for the first time in EU law, an autonomous objective of regulation (recitals No 2 and 31, 33 and 44) which is pursued through a set of *de facto* maximum harmonization standards.[98] The MiFID I adopts a (i) functional and (ii) customized approach to conduct regulation.

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[93] See Article 11(2) and 27 of ISD. See in this sense, S. Grundmann. 'EC Financial Services – Developments 2002–2005' 4 European Review of Contract Law (2005): 490.
[94] See, in particular, C. Cruickshank. 'Is There a Need to Harmonise Conduct of Business Rules', in: G.Ferrarini (ed.), *European Securities Markets – The Investment Services Directive and Beyond*, London – Den Haag – Boston: Kluwer Law International, 1998, 131-134.
[95] See M. Andenas. "Rules of Conduct and the Principle of Subsidiarity" 15 Company Lawyer (1994): 60.
[96] See, N. Moloney. *EU Securities and Financial Markets Regulation*, p. 329 ss.
[97] Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive OJ L 241/26 (2006) and Commission Regulation (EC) No 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record- keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive OJ L 241/1 (2006).3
[98] See Chapter 7, below.

The functional approach aims at avoiding regulatory arbitrage related to the financial innovations and divergences based on national law.[99] To this end, the MiFID I prescribes that conduct rules apply to the provision of financial services and activities to clients,[100] irrespective of the contractual type of financial services and instruments (contracts for sale, mandate).[101]

The MiFID customized approach aims to fully respect the principle of proportionality and to avoid the risks of one-size-fits-all regulation.[102] To this end, the MiFID I and the Commission MiFID I Directive differentiate conduct rules on the basis of the nature of client (retail, professional, eligible counterparty),[103] the type of service (execution-only, investment advice and portfolio management) and the nature of the financial instrument (complex or non-complex). *Ceteris paribus,* the requirements for firms are stricter if: (i) the client is retail; (ii) the financial service involves a higher degree of the firm's influence in the client's investment decision (investment advice or portfolio management), or; (iii) the financial instrument is complex.

Without being possible to examine in detail all the MiFID I conduct of business rules, the following analysis focuses on the rules which have been most frequently litigated before national courts and ADRs after the financial crisis: (i) fair-treatment clause; (ii)suitability rule; (iii) appropriateness rule, and; (iv) execution-only rule. These are detailed further below:

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[99] For the notion of the functional, in comparison to the institutional, approach to financial regulation, see R. C. Merton. '*Functional Perspective of Financial Intermediation'* 24 Financial Management (1995): 23-41 and S. L. Schwarcz. '*Regulating Financial Change: A Functional Approach*' 100 Minnesota Law Review(2016): 1441-1494.

[100] The client is 'any natural or legal person to whom an investment firm provides investment and/or ancillary services' Article 4(1)(10). Please note that Articles 2 and 3 contain several exceptions to the application of MiFID provisions.

[101] See N. Moloney. *EU Securities and Financial Markets Regulation*, p. 341.

[102] See Recital 31 of the Preamble to the MiFID I and Recital 44 of the Preamble to the Commission MiFID Directive.

[103] Under the MiFID regime, natural persons will always have to be treated as retail clients, irrespective of their education level, experience in investing, or wealth, unless they themselves have explicitly requested to be treated as professionals and therefore have waived the protection on an informed basis. See M. Kruithof, W. Van Gerven. 'A Differentiated Approach to Client Protection: The Example of MiFID', Financial Law Institute, Working Paper 2010/07, p. 50.

(i) "a firm shall act honestly, fairly and professionally in accordance with the best interests of their clients" (Article 19(1)).[104] It is unclear, however, whether the scope of this rule is delimited by the subsequent rules of conduct (suitability and appropriateness), or, whether it should extend also to the firm's contractual duties.[105] The fair-treatment clause is also supported by other information requirements, detailed by the Commission MiFID I Directive (Article 37).[106]

(ii) a firm which provides investment advice[107] or portfolio management[108] "shall obtain the necessary information regarding the client's or potential client's (1) knowledge and experience in the investment field relevant to the specific type of product or service, (2) financial situation, and (3) investment objectives, so as to enable the firm to recommend to the client or potential client the investment services and financial instruments that are most suitable" (suitability rule). If the firm does not obtain the information required under Article 19(4) of Directive 2004/39/EC, the firm shall not recommend investment services or financial instruments to the client or potential client (Article 35(5) of Commission MiFID I Directive). The suitability test is a process-based requirement which requires the adviser to deliver personalized information to his client based on the nature of client, the service and the financial instrument.[109] Its rationale is to reduce the principal-agency problem related to the high power that the firm can have on investors'decision making in advisory relationships.

(iii) when providing investment services other than those referred before, "the firm shall ask the client or potential client to provide information regarding his

[104] This rule, however, does not apply to the transactions with eligible counterparties (Article 24(1)) and transactions concluded under the rules governing an MTF (Article 14(3)) and regulated market (Article 42(4)).
[105] See H.-W. Micklitz, J. Stuyck, E. Terryn (eds.). *Cases, Materials and Text on Consumer Law*, Oxford: Hart Publishing, 2010, p. 411.
[106] On the interpretation of Article 19(3) see P. O. Mülbert. 'The Eclipse of Contract Law in the Investment Firm-Client-Relationship: The Impact of the MiFID on the Law of Contract from a German Perspective" in G. Ferrarini, E. Wymeersch (eds.). *Investor Protection in Europe: Corporate Law Making, The MiFID and Beyond* (Oxford: Oxford University Press, 2006): 316.
[107] See on the definition of investment advice: case C-604/11, *Genil 48 SL v Bankinter,* ECLI:EU:C:2013:344, para 55.
[108] For the exclusion of a brokering of a portfolio management agreement from the MiFID I investment service, see Opinion of the Advocate General Campos Sánchez-Bordona in the case C-678/15, *Mohammad Zadeh Khorassani v Kathrin Pflanz*, ECLI:EU:C:2017:100, para 68.
[109] See Moloney. *EU Securities and Financial Markets Regulation*, p. 806.

knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client" (appropriateness rule). If the firm considers that the product or service is not appropriate to the client or potential client, it shall warn the client or potential client; however, unlike the suitability rule the firm can perform the service. The appropriateness rule is lighter than the suitability rule because it presupposes that the client takes his investment decision independently from the firm.[110]

(iv) the suitability and appropriateness rules do not apply if the firm provides only execution and/or the reception and transmission of client orders and certain conditions are met (e.g. the financial product is non-complex and the the service is provided at the initiative of the client or potential client). The rationale for this exemption is that these services have a purely facilitative role and should not involve any influence of the firm on the investor's decision-making (non-intermediated transactions). However, as shown by the litigation emerged in the EU jurisdictions, this service is prone to mis-selling because firms often make implicit and unsolicited recommendations to influence the investor, or offer these products as a condition for the investor to receive other products (e.g. mortgage).

2.2.3. The MiFID II

The MiFID II, which will enter into force on 3 January 2018,[111] is based on on Article 53(1) of the TFEU and, in line with the MiFID I, has the main objective of creating an integrated financial system and ensuring its operational efficiency (recital no 164). However, in comparison to MiFID I the MiFID II reinforces the client protection objective, namely by stressing the link between the firms' misconduct, clients' detriment and loss of investor confidence' (recital no 5) and

[110] See M. Kruithof, W. Van Gerven, "A Differentiated Approach to Client Protection", p. 28.
[111] The MiFID II Commission Proposal was submitted in 2011, the Directive was adopted in 2014 and the entry into force of the MiFID II, originally established on 3 January 2017, has been deferred, due to technical difficulties in its implementation faced by ESMA and NCAs, to 3 January 2018. See Directive 2016/1034 of 23 June 2016 amending Directive 2014/65/EU on markets in financial instruments

introduces a financial stability rationale for regulation, in particular, of the firms' corporate governance (recital no 5).[112] The MiFID II has also been supplemented by Level 2 measures (i.e. a Commission Delegated Directive and a Commission Delegated Regulation,[113] which implement the Level 1 product governance and conduct of business rules, respectively).

Regarding the MiFID I conduct of business rules examined above, the MiFID II introduced the following main innovations:

(i) the MiFID II has redesigned the scope of its conduct of business rules. First, the MiFID II has narrowed the scope of the exemption laid down by the MiFID I for dealing in own account, thus reflecting the need of enhancing investor protection also in non-intermediated transactions.[114] Second, the MiFID II requires firms to conduct suitability and appropriateness tests when selling or advising on structured deposits under particular circumsntaces(Article 25(4)(a)(iv,v).

(ii) the MiFID II, given the large detriment suffered by local public authorities due to the mis-selling of financial derivatives,[115] excludes local public authorities, municipalities from the list of eligible counterparties and of clients who are considered to be professionals while still allowing those clients to ask for treatment as professional clients on request (recital No 104). In addition, this Directive whilst not introducing a more granular distinction within the broad retail client category, suggests that retail clients require enhanced protection with regard to the complexity and innovation of financial products (recital No 79), cross-selling practice (recital No 81), investment advice (recital No 82), best execution (recital No 92).

(iii) as to the fair treatment clause (Article 24(1)) shall apply also to the eligible

[112] See J.-H. Binder. "Governance of Investment Firms under MiFID II" in D. Busch, G. Ferrarini (eds.). *Regulation of The EU Financial Markets*, p. 51.
[113] Brussels, 25.4.2016 C(2016) 2398 final
[114] See, in more detail, K. Lieverse. "The Scope of MiFID II", in D.Busch, G. Ferrarini (eds.). *Regulation of The EU Financial Markets*, p. 41.
[115] See E. Wymeersch. "Regulation and Case law relating to Financial Derivatives" Financial Law Institute, WP 2012/03.

counterparties (Recital No 86 and Article 30(1)). Importantly, the Level 2 specifies, that in addition to the information requirements of the Commission MiFID I (Article 37), the firm should also explain "the functioning and performance of the financial instrument in different market conditions as well as the risks particular to that specific type of instrument in sufficient detail to enable the client to take investment decisions on an informed basis" (Article 48 of the Commission MiFID II Delegated Directive);

(iv) the suitability rule has been tightened by the following innovations. First, the firm must assess, in addition to the client's knowledge and experience, financial situation and objectives, his or her risk tolerance and his ability to bear losses. Second, if the firm provides investment advice recommending a package of services or products bundled pursuant to Article 24(11), the overall bundled package is suitable (Article 25(2)). Third, when providing investment advice, the investment firm shall, before the transaction is made, provide the client with a statement on suitability in a durable medium specifying the advice given and how that advice meets the preferences, objectives and other characteristics of the retail client (Article 25(6)). These new rules, however, do not address one of the main weaknesses of the MiFID Iregime, namely the practice of the implicit and unsolicited recommendations mentioned above. Since these recommendations are given despite the absence of an express advisory agreement, the client faces strong evidential problems to show that the firm breached its suitability rule with respect to its undocumented advice.[116] It is finally worth recalling that the Commission MiFID II Regulation requires the firm to inform the client about the depreciations of the portfolio, thus introducing a duty to provide continuous information in the long-term transaction (Article 62), which some national courts had already recognized under the MiFID I regime.[117]

(v) the MiFID II adds that the appropriateness rule shall extend to the assessment of the bundle of services or products is envisaged pursuant to Article 24(11),[118] the

[116] See P. Giudici. 'Independent Financial Advice' in D. Busch, G. Ferrarini (eds.). *Regulation of The EU Financial Markets*, p. 162.
[117] See Chapter 6, Section 2.2.1., below.
[118] See also ESMA, Guidelines on cross-selling practices. 11/07/2016. ESMA/2016/574.

assessment shall consider whether the overall bundled package is appropriate.

(vi) the MiFID II extended the scope of the execution-only service to include the conclusion of agreements to sell financial instruments issued by an investment firm or a credit institution at the moment of issuance(Article 4(1)(5)). This important innovation captures in the regulatory scope of MiFID the firm practice of distributing financial instruments they issue themselves, i.e. self-placement (recital No 45). In this case, the firm, whilst acting as intermediary, is indeed the contractual counterparty of the client, and this could increase the risk of detriment for the most vulnerable clients.[119]

(vi) the MiFID II introduced new specific requirements for the 'independent advice', including the prohibition of commissions ('inducement ban') to break the vicious cycle between adviced sales and related remuneration, thus increasing clarity to clients as to the service they receive (recital No 74).[120]

2.3. Product regulation: MiFID II and MiFIR

A) Rationale

After the financial crisis, the widespread misconduct by firms – especially regarding the marketing of complex financial products – highlighted the weakness of conduct regulation (i.e. implicit recommendations, conflicts of interest, difficult supervision).[121] To address these weaknesses and reduce mis-selling, the EU and national legislators, besides the new conduct of business rules mentioned above, introduced new requirements governing financial instruments or products in themselves, in order to prevent at an earlier stage the detriment deriving from mis-selling.[122] As the EBA recently stated, the utmost objective of product regulation

[119] ESAs, Placement of financial instruments with depositors, retail investors and policy holders ('Self placement'). 31 July 2014. JC 2014 62.
[120] See, in more detail on the inducement ban, L. Silverentand, J. Sprecher, L. Simons. 'Inducements', in D. Busch, G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, pp. 205-225.
[121] See N. Moloney. *EU Securities and Market Regulation*, p. 807.
[122] For an overview of the product intervention measures adopted by national legislators and supervisory authorities, see ESMA Stakeholder Group. Own initiative report on product intervention

(product governance and product intervention) is precisely that of avoiding "the need for recourse to alternative dispute resolution systems or the courts for compensation".[123]

B) Product governance

Product governance rules require investment firms that produce financial instruments to establish processes for approval of these instruments, approve the financial instruments before they are marketed to clients, identify the target market of end clients, review financial instruments and disclose to distributors relevant information about the financial product and the approval process (Article 16 of the MiFID II and Articles 9, 10 of the MiFID II Delegated Directive). Therefore, in line with the recommendations of the International Organization of Securities Commission's (IOSCO),[124] the MiFID II does not require competent authorities to pre-approve financial products, but it does not prevent this either.[125] Rather, it designs product pre-approval as an internal process which must be established and conducted by the firm itself, under the responsibility of its management (Article 9(3)(b)).

Product governance requirements have a wide scope of application. They apply to both firms that produce (creation, development, issuance and/or design of financial instruments) and firms distributing financial instruments (offer and recommendation).[126] In addition, the MiFID II delegated directive, clarified that "in the interest of investor protection, product governance rules should apply to all products (thus also including shares and bonds) sold on primary and secondary markets, irrespective of the type of product or service provided and of the requirements applicable at point of sale" (recital No 18). Although the MiFID II

under MiFIR. 16 June 2017 ESMA22-106-264.

[123] EBA, Guidelines on product oversight and governance arrangements for retail banking product. Final report. 15 July 2015, EBA/GL/2015/18, p. 40.

[124] IOSCO. Regulation of Retail Structured Products Final Report. December 2013 FR14/13, p. 29.

[125] See, in this sense also the recital No 91 of the Commission MiFID II Regulation and recital No 62 of the Commission MiFID I Directive.

[126] For the notion of creator and distributor, see Article 9(1) and 10(1) of the MiFID II Delegated Directive.

refers these requirements only to investment firms, a teleological interpretation based on the primary client protection purpose of these rules suggests that also credit firms, UCITS and AIFM management companies should be subject to these rules when providing MiFID services and instruments to clients.[127]

The mandatory requirement to identify the product's target market is a key innovation of the EU post-crisis regulatory framework and complements the MiFID suitability/appropriatenes and conflict of interest requirements. According to the Commission MiFID II Directive, manufacturers shall identify "a sufficiently granular level the potential target market" (Article 9(10) except for the simpler financial products (recital no 18). Whilst the protection of client appears to be the primary objective of this obligation, investment firms shall also consider whether the financial instrument may represent a threat to the orderly functioning or to the stability of financial markets before deciding to proceed with the launch of the product (Article 9(4)).

The product governance requirements do not prejudice the application of the suitability/appriopriateness requirements, which apply subsequently, at the point of sale, and require a concrete assessment of the individual client.[128] Therefore, the intermediary should not distribute a product that, although compatible, *in abstracto*, with the client's needs, is not suitable, *in concreto,* and conversely the intermediary can distribute a financial product that is not targeted to the clients' class, if the product is suitable for the client.[129] ESMA complemented the Level 1 and Level 2 product governance requirements with its good practices for product govrnance arrangements and a draft guideline which details the concrete rules for the application of the legislative requirements.[130]

Finally, it is worth mentioning that if the investment firm breaches its product governance obligations, the competent authorities can suspend the marketing or

[127] ESMA. Technical Advice to the Commission on MiFID II and MiFIR. Final Report. 19 December 2014 ESMA/2014/1569, p. 52 ("ESMA technical advice").
[128] See recital No 15 of the MiFID II Delegated Directive and ESMA, Draft Guidline on product governance, para 25.
[129] See P. Giudici. 'Independent Financial Advice', D. Busch, G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, p. 161.
[130] ESMA. *Draft guidelines on MiFID II product governance requirements*. 5 October 2016. ESMA/2016/1436.

sale of financial instruments or structured deposits (Article 69(2) (t)).

C) Product intervention

The MiFIR conferred on the ESAs and the NCAs the power to restrict or prohibit, also on precautionary basis, financial products or practices.[131] The scope of the MiFIR product intervention powers remains, however, unclear. According to the ESMA, the product intervention powers apply only to products marketed and distributed by credit institutions and investment firms and cannot apply to fund management companies which distribute units in investment funds directly.[132] However, the ESMA stakeholder group recently advised ESMA that MiFIR intervention powers should apply also to fund management companies in particular because "the investor protection purpose of the product intervention measures would obviously be undermined if the narrow interpretation of the competences of the authorities would be followed".[133]

The ESAs can adopt product restrictive measures if: (i) the regulatory requirements under Union law that are applicable to the relevant financial instrument or activity do not address the threat;[134] (ii) the NCAs have not taken action (or adequate action) to address the threat; (iii) there is threat to the market integrity, financial stability or there is a significant investor protection concern.[135] The ESMA product intervention powers have been designed to be a last resort measure which should be deployed only 'when other investor protection measures, including product govrenance rules, fail to produce the desired effect'.[136]

The Commission MiFIR Regulation specified that the 'threat' requires a greater

[131] See also Chapter 4, below.

[132] ESMA. Opinion on the Impact of the exclusion of fund management companies from the scope of the MiFIR Inter- vention Powers. 12 January 2017 ESMA50-1215332076-23. ESMA therefore called the EU institutions 'to address the risk of arbitrage between MiFID firms and fund management companies'.

[133] ESMA Stakeholder group. Own initiative report on product intervention under MiFIR. 16 June 2017 ESMA22-106-264.

[134] See however ESMA, Technical advice, p. 189 where ESMA expresses the view that product intervention should be a complementary tool to support existing EU regulatory requirements.

[135] See, in more detail, D. Busch. 'Product Governance and Product Intervention under MiFID II/MiFIR', D. Busch, G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, p. 137. Product intervention powers have been conferred to the ESAs and NCAs also by the PRIIPs Regulation and, only to the ESMA, by the short-selling regulation.

[136] ESMA Stakeholder group. Own initiative report on product intervention under MiFIR. 16 June 2017 ESMA22-106-264, 8.

concern than a 'significant concern', which is the prerequisite of the intervention for investor protection (recital No 18). More importantly, this Regulation, lists 21 factors, divided in other criteria, which shall be used by competent authorities to assess whether there is a significant investor protection concern or a threat to market integrity or financial stability (Article 19).[137] In line with the ESMA technical advice, the list of factors include not only objective elements (pricing, leverage) but also subjective elements (clients' skills and abilities, level of education, economic situation, including their income and wealth) that reflect the regulator's attention to the retail clients' vulnerabilities.[138] In addition, the Commission specified that the criteria/factors should not be applied cumulatively and that the presence of only one of them could justify the measure (recital no 19). However, the most remarkable difference from the ESMA technical advice,[139] is that the list of factors is meant to be exhaustive (Article 19(2)) and therefore the ESMA and the NCA should not take into account other criteria than those laid down therein. Although the objective of an exhaustive list is to limit the ESMA's discretion, its practical impact is limited because among the factors to be considered is 'whether a financial instrument, financial activity or financial practice may threaten investors' confidence in the financial system' (Article 19(2)(u)). Admittedly, this factor is a general clause that presumably could include all the other possible factors not expressly mentioned in the list.

3. Retail client protection and financial stability: bridging the opposites?

The post-crisis EU investor protection regulation features two main changes: the strengthening of disclosure, distribution and product regulation rules specifically aimed at protecting retail unsophisticated clients and, and more strikingly, the infusion of these protective rules with financial stability-related concerns. The

[137] See ESMA, MiFID II/MiFIR, Consultation paper, 22 May 2014 (ESMA/2014/549) and Final report, 19 December 2014 (ESMA/2014/1569), p. 189; EBA, Draft Technical advice on possible delegated acts on criteria and factors for intervention powers concerning structured deposits under Article 41 and Article 42 of Regulation (EU) No 600/2014 (MiFIR), 5 August 2014 (CP/2014/20); EIOPA, Product Intervention Powers under the Regulation on Key Information Documents for Packaged Retail and Insurance-Based Investment Products (PRIIPs), 27 November 2014 (CP/14/064).
[138] ESMA Stakeholder Group. 'Advice to ESMA. Investor Protection Aspects of the Consultation Paper on MiFID II and MiFIR' 8/08/2014, ESMA/2014/SMSG/035, p. 26 (criticising the absence of subjective criteria to assess product' complexity).
[139] See ESMA, Technical advice, p. 191 (specifying that the list should not be exhausting).

underpinning rationale is that firms'misconduct is not only detrimental for the individual client but also for the financial system as a whole, undermining the confidence of the market participants in the well functioning of the financial market.

The instrumentalization of client protection tools to achieve financial stability seems to be part of a broader trend which emerges also from other EU post-crisis measures. On the one hand, the BRRD[140] and SRM Regulation, by (almost entirely) replacing public support to failing banks (bail-outs) with a system of private contribution by shareholders and bondholders (bail-ins), inevitably require these clients, who are not necessarily sophisticated clients, to assess the creditworthiness of the bank, thus implicitly endorsing the model of the informed, reasonable and responsible investor.[141] On the other, the ESFS and the SSM have the primary objective of ensuring financial stability, whilst the consumer objective ranks as a secondary and instrumental objective, to be pursued primarily by national authorities.

Client protection and financial stability are mutually reinforcing objectives but conflicts can arise in several forms. In particular, the need of reducing systemic risk could lead regulators to approve issuances and distribution of complex financial products to stregnthen the capital position of the firrms or to limit or restrict private enforcement of conduct regulation, especially against systematically important financial firms or to restrict the principle of *pacta sunt servanda*. To better clarify the the interplay between client protection and financial stability, it is therefore necessary to examine how EU law has deployed private law (chapter 3) and private enforcement instruments (chapter 5 and 6) as well as financial supervision (chapter 4) after the financial crisis.

[140] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms ('BRRD') OJ L 173/190 (2014).
[141] See F. Della Negra. 'The transformation of the retail financial transactions in the EU and the role of contract law', p. 115.

Chapter 3 – THE OBJECTIVES AND TOOLS OF PRIVATE LAW AND ENFORCEMENT: CONCEPTUAL FRAMEWORK

1. Regulating private law and private enforcement in the EU financial markets

After the global financial crisis, the role of private law in financial regulation has been the subject of increasing academic attention. The high level of financial litigation experienced across Member States has triggered new scientific interest in the intersections between the goals of financial regulation and private law, in the modes of impact of EU-derived conduct rules on national private law and in the different approaches followed by national courts in enforcing financial contracts and EU-derived standards.

Building on this literature,[142] this chapter mainly aims to explain and conceptualize the role of private law and enforcement in EU financial regulation by looking at the regulatory techniques adopted by the EU to shape rights, remedies and procedure[143] and ultimately affect national private laws. Its ultimate purpose is to offer a conceptual framework to examine, in Part II and Part III of the thesis, how different institutional actors (supervisors, courts and ADRs) can affect the functioning of private law in financial regulation.

This chapter, likewise the previous one, looks at the substantive (or content level) of contract governance but from the perspective of the private law rights, remedies and procedures. In this vein, it is argued that after the financial crisis the EU has not only intensified its investor protection rules, but it has also gradually changed its regulatory approach towards private law remedies and procedures (private enforcement). Whereas before the crisis, the EU focussed on the harmonization of right-conferring rules, leaving for the Member States the 'regulation' of private

[142] See, for a review of the essential literature, Chapter 1, above.
[143] Following the definitions of Van Gerven (W. Van Gerven. 'Of rights, remedies and procedures' 37 Common Market Law Review (2001):, 501) the concept of 'right' indicates an entitlement that individuals can enforce vis-à-vis the State or other individuals through remedies and procedures; a 'remedy' enables a party to make good infringements of the rights by imposing negative legal consequences on the wrongdoer; a 'procedure' enables a party to action a remedy before a court or an alternative dispute resolution mechanism.

enforcement, after the crisis the EU has become more practive and started harmonizing private law remedies and procedures. The main theoretical implication of this change is that the EU, by increasing the level of regulation on private law and enforcement, restricts the procedural and remedial autonomy of Member States and, consequently, introduces limitations to the traditional model of private autonomy, moving towards a model of "regulated-autonomy".

2. The objectives of private law in financial markets

2.1. Autonomy-driven private law

Legal scholars have put forward numerous (positive and normative) theories to explain the rationale and objectives of private law.[144] For the sake of this study, it is important to consider two main conceptions of private law which have been discussed in the EU: the "autonomy-driven" (or classical) and "regulatory-driven" private law.

The autonomy-driven private law aims to safeguard the parties's autonomy. The fundamental component of the party's autonomy is the freedom of contract, i.e. the freedom to choose the contracting party and the terms of the agreements and the freedom to enforce that agreements, without any interference from other private parties or public entities.[145] This notion of freedom of contract characterizes a "classical" conception of private law, enshrined in the civil codes adopted in the XIX Century and in the general common law[146]. Classical contract law, based on the dogma of the formal equality of contracting parties and privity of contracts, does not tolerate any intrusion of social, economic, political values. The ultimate goal of this autonomy-driven private law is indeed the individual self-interest and liberty,

[144] See, for an overview, M. W. Hesselink. 'Contract theory and EU contract law' in C. Twigg-Flesner (ed.). *Research Handbook on EU Consumer and Contract Law*, p. 508.
[145] For the philosophical and historical foundations of freedom of contract see in particular H.-W. Micklitz. 'On the Intellectual History of Freedom of Contract and Regulation' 4 Penn State Journal of Law & International Affairs (2015): 11.
[146] See P. S. Atiyah. *Essays on Contract*, Oxford: Oxford University Press, 1990, p. 12.

and therefore the commutative justice.[147]

2.2. Regulatory-driven private law

Recent doctrinal theories have challenged this "pure conception" of private autonomy and developed other models of private law which entail a certain degree of intrusion of public values in the traditional concept of autonomy. The overall idea is that private law should not only by driven by the autonomous goal of party autonomy but it should also be infused with the "heteronomous goals" set by the legislator and other public authorities (instrumentalization or functionalism).[148] In its extreme variant, instrumentalization entails that private law should be simply considered as a form of regulation, because it is in fact 'law', and should not be conceptually differentiated from other typical regulatory instruments (e.g. tax law, criminal law) which also aim to ensure the public interest.[149] In its moderate variant, instrumentalization recognizes that private law can be instrumentalized to achieve the public goals but underlines, as a difference from regulation, its 'empowerment' function; namely, the fact that the individual – and not the state or its organs – is ultimately responsible for arranging his business and for vindicating its rights.[150]

In the EU-regulated markets, this empowering function may be reflected not only in restrictions on one contracting party (i.e. the consumer or the client) but also in the

[147] See in particular L. Kaplow, S. Shavell. 'Why the Legal System Is Less Efficient than the Income Tax in Redistributing Income' 23 Journal of Legal Studies (1994): 667 and L. Kaplow, S. Shavell. 'Should Legal Rules Favor the Poor? Clarifying the Role of Legal Rules and the Income Tax in Redistributing Income' 29 Journal of Legal Studies (2000): 821. For a discussion on these theories see S. Grundmann. 'Three Views on Negotiation – An Essay between Disciplines' in K. Purnhagen, P. Rott. *Varieties of European Economic Law and Regulation: Liber Amicorum for Hans Micklitz*, Springer, (2014), p. 17.

[148] See in particular H. Collins. *Regulating Contracts*, Oxford: Oxford University Press, 1999 and F. Cafaggi. 'Introduction', in F. Cafaggi (ed.). *The Institutional Framework of European Private Law*, Oxford: Oxford University Press, 2006, 1.

[149] See in particular F. Möslein, K. Riesenhuber. "Contract Governance", 274 (in relation to the governance by means of contract law).

[150] See H. –W. Micklitz, Guido Comparato, Yane Svetiev. "The regulatory character of European private law" in Christian Twigg-Flesner (ed.), Research Handbook on EU Consumer and Contract Law. Research Handbooks in European Law series, p. 46; G. Bellantuono. 'The Limits of Contract Law in the Regulatory State' 2 European Review of Contract Law (2010): 116; A. Zoppini. 'Diritto Privato vs Diritto Amministrativo (ovvero alla ricerca dei confini tra stato e mercato) 3 Rivista di diritto civile (2013): 527.

promotion of the autonomy of certain market actors (i.e. investment firms which intend to enter financial markets).[151] This is because in the internal market 'the new autonomy of private law takes place not in the presence and under the protection of a state but rather in, and due to, its absence.'[152] Therefore, just as markets, after liberalization, needs to be re-regulated,[153] the autonomy of markets participants, need to be subject to the same re-regulatory adjustment. The ultimate goal of regulatory-driven private law is a contribution to the public interest and therefore, to a greater or lesser extent, the redistribution of economic and social resources within the society.[154]

3. The objectives of private enforcement in financial markets

In this study, private enforcement indicates the enforcement actions driven by the initiative of private parties (individuals or firms), irrespective of the private or public nature of the enforcement mechanism (e.g. court or arbitration) and the private or public nature of the rule which is enforced (e.g. contract terms, private law or financial regulation). Hence, it will be argued that private parties can enforce, via courts or ADRs, not only typical horizontal duties, applying between them (contract and contractual duties) but also vertical duties, applying between the public authority and a private party (regulatory duties). Likewise private law, private enforcement can be driven by autonomous (e.g. compensation) or etheronomous (e.g. deterrence) objectives. In EU financial regulation, however,

[151] See H.-W. Micklitz. "The Visible Hand of European Regulatory Private Law: The Transformation of European Private Law from Autonomy to Functionalism in Competition and Regulation' 3; N. Reich. *General Principles of EU Civil Law*, Cambridge: Intersentia: 20; H.-W. Micklitz, G. Comparato. 'Regulated Autonomy between Market Freedoms and Fundamental Rights', in U. Bernitz, X. Groussot, F. Schulyok (eds). *General Principles of EU Law and European Private Law*, Alphen aan den Rijn: Kluwer, 2013).

[152] See R. Michaels, N. Jansen. 'Private Law Beyond the State? Europeanization, Globalization, Privatization'. Duke Law School Legal Studies Research Paper Series Research Paper No. 137 (2007): 19.

[153] See in particular S. Cassese. 'Quattro paradossi sui rapporti tra poteri pubblici ed autonomie private' 2 Rivista Trimestrale di Diritto Pubblico (2000): 389.

[154] See, for distributive justice theories in contract law see, in particular, A. T. Kronmann. 'Contract Law and Distributive Justice' 89 The Yale Law Journal (1980): 472.; A. Bagchi. 'Distributive Justice and Contract', in G. Klass, G. Letsas, P. Saprai (eds.). Philosophical Foundations of Contract Law, Oxford: Oxford University Press, 2014, 196; T. Wilhelmsson. 'Varieties of Welfarism in European Contract Law' 10 European Law Journal (2004): 712–733. For an overview of the distributive justice theories, see H.-W. Micklitz (ed.), The Many Concepts of Social Justice in European Private Law, Cheltenham: Edward Elgar, 2011.

these objectives have assumed a particular meaning and they have also been recently juxtaposed to a new objective of ensuring financial stability.

3.1. Compensation

As mentioned, the traditional objective of private law remedies and procedures is to make up for the actual loss suffered by the injured party as a result of the breach of contractual or legal rules (e.g. duty of care, duty of good faith) by the other. Traditional compensation theories ultimately aim to restore the commutative justice between the parties and for this reason they can be associated to the traditional conception of private law and private autonomy.[155]

These traditional compensatory theories have been criticized because they do not ensure the effectiveness of regulation in the modern complexity of modern financial markets:[156] the traditional instruments of private law (e.g. causation, evidential rules) obstacolate the effective recovery of the loss suffered by the plaintiff. In addition to this, compensation-driven remedies can generate a sub-optimal level of litigation because the social cost of the lawsuit may outweight, by far, its private costs (e.g. in the case of frivolous and vexatious litigation) and can result in 'pocket shifting' because plaintiffs are often shareholders of the defendant or of other competing firms also involved in mis-selling.[157]

However, in EU law, compensation goes beyond its traditional function enshrined in national private laws. Compensation is indeed conceived as the minimum remedy to protect individual rights conferred by EU law, both in state liability and horizontal liability cases.[158] This objective emerges also from the MiFID I and MiFID

[155] See A. Schwartz, R. E. Scott. 'Contract Theory and the Limits of Contract Law' 113 Yale Law Journal (2003): 1. See, with regard to corporate contracts, F. H. Easterbrook, D. R. Fischel. 'The Corporate Contract' 89 Columbia Law Review (1989) p. 1421. See S.L. Schwarcz. ' Private Ordering of Public Markets: the Rating Agency Paradox' 2 University of Illinois Law Review (2002): 27.
[156] See E. Avgouleas. The Mechanics and Regulation of Market Abuse: A Legal and Economic Analysis, Oxford: Oxford University Press, 2005, p. 158.
[157] See T. Baker, S. J. Griffith. *Ensuring Corporate Misconduct. How Liability Insurance Undermines Shareholder Litigation*, Chicago, 2010, p. 6.
[158] See in particular N. Reich. 'Horizontal Liability in EC Law: Hybridization of Remedies for Compensation in Case of Breaches of EC Rights' 44 *Common Market Law* Review (2007): 708. See also the Opinion of the Advocate General Jaaskinen in Case C‑536/11, Bundeswettbewerbsbehörde

II, which introduce extra-judicial mechanisms to compensate losses suffered by consumers and, more clearly, from the PRIIPs Regulation which harmonizes the civil liability of the manufacturer with the declared objective to grant to 'all retail investors across the Union have the same right to seek compensation' (recital No 22).

3.2. Deterrence

The other traditional rationale for conferring private law remedies on investors is to deter financial firms (issuers and intermediaries) from future misconduct, with the ultimate aim of forcing firms to internalize the social cost (profit) of the wrongdoing. [159] Deterrence theories, which are associated with distributive justice goals, consider the plaintiff not as a self-interested individual but as a 'private attorney general' acting in the public interest.[160]

Ever since the landmark case *Van Gend en Loos*, the CJEU has stressed this 'public function' of private enforcement: "the vigilance of the individuals to protect their rights amounts to an effective supervision in addition to the supervision entrusted to the Commission and Member States".[161] Further, the CJEU reiterated the dissuasive and deterrent function of private enforcement particularly in the field of competition law, with respect to the sanction of nullity of Article 101 of the TFEU,[162] and in consumer law, with particular regard to the 'sanctions' laid down by the Directive 1993/13/EEC against unfair contract terms.[163]
On the basis of this case law, some have argued that the conferral of individual

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v Donau Chemie AG: ECLI:EU:C:2013:67, para 48.

[159] See in particular J. C. Coffee Jr. 'Reforming the Securities Class Action: An Essay On Deterrence and Its Implementation' Columbia Law School , Working Paper No. 293; J. Maria Glover, 'The Structural Role of Private Enforcement Mechanisms in Public Law' William and Mary Law Review (2012): 1162; L. E. Mitchell. The "Innocent Shareholder": An Essay on Compensation and Deterrence In Securities Class Actions' 243 Wisconsin Law Review (2009): 287.

[160] See T. Frankel. 'Implied Rights of Action' 67 Vanderbilt Law Review (1981): 533.

[161] See F. Wilman. *Private Enforcement of EU Law Before National Courts. The EU Legislative Framework*, Cheltenham: Edward Elgar, 2015 p. 548.

[162] Case C-453/99, Courage Ltd, ECLI:EU:C:2001:465, para 27 and case C-295/04, Manfredi, ECLI:EU:C:2006:461, para 27

[163] Case C-618/10, *Banco Español de Crédito SA*, ECLI:EU:C:2012:349, para 69 and See also Commission, Second report on Consumer Injunctions Directive 2009/22, COM(2012) 635, p. 7.

rights is only an instrument to ensure the overriding objective of ensuring the effectiveness of EU law per se.[164] In EU financial law, however, the role of deterrence as a rationale for the private enforcement is more limited. Whilst numerous Directives require Member States to establish effective, proportionate and dissuasive administrative sanctions for the firms' infringements,[165] they do not expressly link private remedies and enforcement to the aim of achieving a dissuasive effect.[166] Only recently, the EU legislator and the CJEU have stressed the deterrent function of private enforcement. The new civil liability regime introduced by the Credit Rating Regulation[167] seeks to deter these market actors from providing false ratings, rather than compensating private investors (given that credit rating agencies are covered by insurances).[168] In the recent *Hirmann v Immofinanz AG*,[169] further examined below,[170] the CJEU decided that a civil liability regime which compensates the entire purchase price of the securities is an appropriate remedy for an investor who has suffered a loss as a result of the firm's breach of prospectus-related rules and is is also capable of deterring issuers from misleading investors.

However, also the deterrence-driven private law has been criticized for reducing the efficiency of financial markets, particularly because it could lead to an increase of vexatious litigation and to the shifting of the cost of damages to shareholders and clients, especially if the defendant firm is insured. More recently, it has been argued that deterrence also needs to be appropriately calibrated in the case of systemic harm because it could lead to the imposition of damages so large as to cause the

[164] See F. Jacobs. 'The Evolution of the European Legal Order' 41 Common Market Law Review (2004): 308; S. Prechal. *Directives in EC Law*, Oxford: Oxford University Press, 2005, p. 111.
[165] See Article 51 of the MiFID I, Article 14(1) of Directive 2003/6, recitals No 70, 71 of the Regulation (EU) No 596/2014 of the European Parliament and of the Council of 16 April 2014 on market abuse (market abuse regulation) Article 70 of the MiFID II.
[166] See in particular, V. Tountopoulos. 'Market Abuse and Private Enforcement' 3 European Company and Financial Law Review (2014): 312.
[167] Regulation (EU) No 462/2013 of the European Parliament and of the Council of 21 May 2013 amending Regulation (EC) No 1060/2009 on credit rating agencies ('CRA Regulation') OJ L 146/1 (2013).
[168] See M. Lehmann. 'Civil liability of rating agencies—an insipid sprout from Brussels' 11 Capital Markets Law Journal (2016): 62.
[169] Case C-174/12, *Hirmann v Immofinanz AG*, ECLI:EU:C:2013:856.
[170] Chapter 8, below.

failure of the firm, thus ultimately leading to under-deterrence.[171]

3.3. Financial stability

After the global financial crisis, some theories have departed from the compensation–deterrence dichotomy and suggested that that private enforcement should aim at reducing the systemic shocks related to the fundamental uncertainty that characterizes post-modern financial markets.[172] In particular, K. Pistor argued that there is paradox between law and finance because "especially in times of financial crisis, the full enforcement of legal commitments would result in the self-destruction of the financial system and this law-finance paradox tends to be resolved by suspending the full force of law where the survival of the system is at stake".[173] A concrete application of a stability-driven private enforcement is the collective action clause which, derogating from the principle of *pacta sunt servanda,* allows a supermajority of bondholders to agree to a debt restructuring that is legally binding on all holders of the bond, including those who vote against the restructuring.[174]

This financial-stability theory is also profoundly different from client protection-driven private law because it entails that the 'public good' of financial stability can, and should, lead to to sacrifice the interest of vulnerable investors (e.g. through bail-in measures) if this is necessary for the sake of protecting an overriding interest (e.g. stability of banking system). To this end, limitations of access to justice and restrictions to the availability of private law remedies are normatively justified to avoid that the effective enforcement of the law leads to weaken the

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[171] See J. Armour, J. N. Gordom. 'Systemic Harms and Shareholders Value' 6 Journal of Legal Analysis (2014): 6.

[172] See J. Kongden. '*Policy Responses to Credit Crisis. Does the Law of Contract Provide an Answer?' in S. Grundmann,* Y. M. Atamer, Financial Services, Financial Crisis and General European Contract Law, Failure and Challenges of Contracting, Alphen aan den Rijn: Wolters Kluwer, 2011, p. 44; K. Pistor. 'Legal Theory of Finance', 315–330; J. Black. 'Seeing, Knowing, and Regulating Financial Markets', 16.

[173] See particular K. Pistor. 'Legal Theory of Finance', 315. For a criticism of this theory see S. L. Schwarcz.'Regulating Financial Change: A Functional Approach', 1468.

[174] See in particular A. Gelpern, G. Mitu Gulati. 'The Wonder Clause' 41 Journal of Comparative Economics (2013): 367; G. Mitu Gulati, L. C. Buchheit.'How to Restructure Greek Debt'47 Duke Law Working Papers. Paper (2010). Available on http://scholarship.law.duke.edu/working papers/47 and K. Alexander. 'Regulating Sovereign Bond Contracts in Europe, in S. Grundmann, F. Möslein, K. Riesenhuber. Contract Governance: Dimensions in Law and Interdisciplinary Research, p. 452.

capital position of individual firms, reduce the investors' confidence and ultimately destablising financial markets. It remains to be seen, however, whether these theories are compatible with the EU legal framework and whether they can ensure the full respect of the EU fundamental rights.

4. The EU regulatory design for private law and enforcement

4.1. The institutional context: *ubi jus, ibi remedium*

The most important specificity of the EU legal order, in comparison to traditional legal orders designed under international laws, is that it confers directly enforceable rights on individuals. Ever since *Van Gend en Loos*,[175] the CJEU held that a remedy shall be granted to protect an enforceable right that the individual derives directly from EU law (*ubi jus, ibi remedium*).[176] However, since the EU does not have its own courts to enforce these rights and, in general, does not lay down the remedial and procedural conditions to actionate them, individuals must resort to national courts, remedies and procedures to enforce the rights derived from EU law.

Nevertheless, in accordance with the principle of sincere cooperation (Article 4 of the TUE), such remedies and procedures shall not be less favourable than those relating to similar actions of a domestic nature (i.e. the principle of equivalence) and must not make it impossible in practice or excessively difficult to exercise the rights which are based upon or derived from EU law (i.e. the principle of effectiveness).[177] Moreover, Article 19 of the TEU, in light of Article 47 of the CFR, introduces a higher standard of effectiveness namely by requiring Member States to ensure that the remedies are sufficient or adequate to guarantee effective legal

[175] Case C-26/62, *Van Gend and Loos*, ECLI:EU:C:1963:1, para 3.
[176] See W. Van Gerven. 'Of Rights, Remedies and Procedures', 511; N. Reich. 'Horizontal Liability in EC Law: Hybridization of Remedies for Compensation in Case of Breaches of EC Rights' 708; H.-W. Micklitz. 'The ECJ between the Individual Citizen and the Member States: A plea for a judge-made European law on remedies', in H.-W. Micklitz and B. DeWitte (eds). *The European Court of Justice and the Autonomy of Member States*, Cambridge: Intersentia, 2012, p. 352.
[177] See in particular Case C-33/76, *Rewe-Zentralfinanz and Rewe-Zentral*, ECLI:EU:C:1976:188.

protection of individual rights (Article 19 of the TEU).[178]

4.2. "Process-oriented" and "outcome-oriented" contract law governance

In order to calibrate private enforcement (i.e. rights, remedies and procedures), the EU can choose at least three different regulatory strategies. It can harmonize: (i) only right-conferring rules, thus leaving Member States free, within the boundaries of the principle of effectiveness and equivalence, to translate them into private law obligations and corresponding remedies; (ii) also the procedural rules but leave to the Member States the task to provide for the remedies; (iii) rights, remedies and procedures.

Whilst in Chapter 8 we will investigate in depth these forms of "private enforcement regulation", it is important to understand, from a contract governance perspective, what the significance of these regulatory strategies is. It is argued that they can be grouped in two essential mechanisms: process-oriented and outcome-oriented. Process-oriented mechanisms leave marging of manouvre to national private law as to the means to achieve the outcome set by EU law (protection of individual right). They comprise, for example, default rules, pre-contractual information duties, *ex officio* control of unfair contract terms. By contrast, outcome-oriented mechanisms restrict the margin of manouvre for national private law because they tend to regulate also the way in which the outcome should be achieved. To this end, the EU may introduce mandatory contract rules, minimum content rules, remedies for defect of consent, remedies for breach of contract.[179] The sole harmonization of rights entails a process-oriented mechanisms because the EU defines the outcome (protection of individual right) but delegates to national law the means to achieve it (through remedies and procedures). At the same time, the harmonization of remedies and/or procedures entails a more intrusive, outcome-driven approach.

[178] See Chapter 8, below.
[179] See also, but referring to the procedural and substantive contract governance mechanisms, see F. Moslein, K. Reihsenhuber. 'Contract Governance' 271.

It is argued that whilst before the financial crisis the EU had mainly relied upon process-oriented mechanisms, (i.e. by harmonizing right-conferring and, partially, procedural rules), after the crisis it moved towards an outcome-oriented strategy, based on the gradual harmonization or remedies and procedures.[180] To substantiate this thesis, the following sections will examine the key measures of EU financial regulation.

5. The pre-crisis EU regulatory approach: the "process oriented" governance

5.1. The ISD and the MiFID I

In EU investor protection regulation, the clients' rights are typically conferred indirectly, namely by imposing sufficiently precise and unconditional obligations on the contracting party.[181] This regulatory technique characterizes the conduct of business regulation of the ISD, MiFID I and MiFID II. The MiFID I, as shown above, departed from the 'high level' conduct principles laid down by the ISD, and established a detailed set of conduct rules, further specified by the Commission MiFID I Directive. The MiFID imposes information duties on the firm but does not make a distinction between marketing communication, pre-contractual information and contractual information. To be sure, the MiFID I rules entail that a written contract shall be in place between the firm and the retail client (Article 19(7) and Article 39 of the Commission MiFID I Directive) but did not prescribe any minimum content for this agreement[182] and does not specify what is the consequence for breaching this obligation and rather pinpoints that this requirement does not impose obligations regarding the form, content and performance of contracts for the provisions of investment services (recital No 41). The choice not to harmonize contract law remedies, driven by necessity (difficulty to harmonize civil law

[180] The concept of selective and complete harmonization, which concerns its scope, should not be confused with that of minimum and maximum harmonization, which concerns its intensity.
[181] See in more detail on the indirect conferral of rights T. Eilmansberger. 'The relationship between rights and remedies in EC law' 41 Common Market Law Review (2004): 1241.
[182] See the CESR's Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments. 1st Set of Mandates January 2005. Ref.: CESR/05-024c, 59 (The advice is not intended to interfere with national contract law any more than is necessary for the implementation of the proposed level 2 provisions. In particular the advice is not intended to interfere with the way in which contracts are concluded, amended, renewed or terminated under the applicable law of the Member States.)

remedies)[183] and convinction (risks of opportunistic litigation),[184] has given rise to the vexed issue whether the MiFID standards can be, and shall be, enforced by private investors through national private law remedies.

Whilst the question as to whether MiFID conduct rules are right conferring remains doubtful,[185] a general indication is that it empowers Member States to establish out-of-court mechanisms for consumer disputes (Article 75). Dispute resolution mechanisms presuppose that retail clients can actually have valid private claims; it should thus be seen as an implicit expression of a legislative intention to create rights of action for breach of the directives' protective norms.[186]

6. The post-crisis EU regulatory approach: towards the "outcome-oriented" governance

6.1. The MiFID II

In addition to the procedural mechanisms of the MiFID I, the MiFID II introduced new outcome-oriented mechanisms for protection. First, the Commission MiFID II Regulation introduces a minimum content for the written basic agreement, which aims to "provide legal certainty and enable clients to better understand the nature of the services provided" (recital No 90). The written basic agreement shall set out "the essential rights and obligations of the parties, and shall include specific information regarding investment advice and portfolio management services" (Article 58).[187] The MiFID II does not introduce any remedy for the breach of these requirements, nor for the breach of its conduct of business rules. The Commission proposal to introduce a harmonized civil liability regime for the losses caused to

[183] See T. Tridimas. 'EU Financial Regulation: Federalization, Crisis Management and Law Reform' in P. Craig, G. De Burca (eds.). The Evolution of EU Law, 2nd ed., Oxford: Oxford University Press, 2011, p. 794.
[184] See I. MacNeil. 'Enforcement and Sanctioning,' in E. Ferran, N. Moloney, N. Payne (eds.). Oxford Handbook on Financial Regulation, cit., p. 293.
[185] See Chapter 8, below.
[186] C. C.Hadjiemmanuil. 'The Banking Union and Its Implications for Private Law: A Comment", 390.
[187] ESMA Technical Advice, 164, included also other information in the written agreement and clarified that this should be a minimum requirement for Member States.

clients for the breach of MiFID's conduct of business rules was dropped in the legislative process.[188]

However, as I will show in Chapter 4, the MiFID II requires (and does not only allow) Member States to establish out-of-court mechanisms for consumer dispute resolution and, more importanlty, to set up mechanism to compensate investors for the firms' breach of conduct of business rules. These regulatory innovations witness the intention of the regulator to empower retail clients with remedies and procedures.

6.2. The PRIIPs Regulation

The trend towards the remedial empowerment of the retail client emerges also from the PRIIPs Regulation.[189] This Regulation confers on the retail investor who demonstrates loss resulting from reliance on a key information document ('KID') the right to claim damages from the PRIIP creator for that loss in accordance with national law. This remedy aims to ensure that all retail investors have an effective right of redress (recital No 22). However, the manufacturer cannot be liable solely on the basis of the KID and his liability is restricted to the cases where the KID is misleading, inaccurate or inconsistent with the relevant parts of legally-binding precontractual and contractual documents or with other legislative requirements (Article 11(2)).[190] This provision significantly innovates the Commission's proposal which had established a mandatory rule requiring the product manufacturer to prove that the KID is compliant with the law, when the retail investor demonstrates a loss (Article 11(2)).[191]

6.3. The Credit Rating Agencies Regulation

[188] Commission, Public Consultation. Review of the Markets in Financial Instruments Directive (MiFID), 8.12.2010, p. 63.
[189] Regulation (EU) No 1286/2014 of the European Parliament and of the Council of 26 November 2014 on key information documents for packaged retail and insurance-based investment products ('PRIIPs Regulation') OJ L 352/1 (2014).
[190] See also Article 6(2) of the Prospectus Directive.
[191] Commission, Proposal for Regulation of the European Parliament and of the Council on key information documents for investment products Strasbourg, 3.7.2012 COM(2012) 352 final.

The CRA Regulation introduces a complex liability regime for the damages suffered by issuers and investors because of a Credit Rating Agency's breach of the rules laid down in the Regulation. This new regime, which has been subject to long negotiations to strike a balance between immunity and over-deterrence,[192] presents the following main features. First, the investor or issuer may claim damages only if a credit rating agency has committed, *intentionally or with gross negligence* (my emphasis), any of the infringements listed in Annex III having an impact on a credit rating (Article 35a(1)). This provision departs from the Commission's proposal which laid down for a strict liability regime. Second, if the plaintiff is an investor, he or she may claim damages where it is established that he or she has *reasonably relied, in accordance with Article 5a(1) or otherwise with due care* (my emphasis), on a credit rating whereas if the plaintiff is an issuer he can claim damages if he demonstrates that the infringement was not caused by *misleading and inaccurate information* (my emphasis).

Likewise the PRIPs Regulation, Article 35a(4) specifies that terms such as 'damage', 'intention', 'gross negligence', 'reasonably relied', 'due care', 'impact', 'reasonable' and 'proportionate' shall be interpreted and applied in accordance with the applicable national law as determined by the relevant rules of private international law. Although the recital No 35 justifies this to allow Member States "to maintain national civil liability regimes which are more favourable to investors or issuers or which are not based on an infringement of Regulation (EC) No 1060/2009", there is clearly a risk that this legislative technique runs against the principle of the autonomous interpretation of EU law concepts and could undermine the uniformity of the CRA's liability regime.[193] Finally, the CRA Regulation specifies that this special liability regime does not exclude further civil liability claims in accordance with national law. This provision could refer to cases of joint liability of legal or natural persons with the CRA as to leave to the national law the regulation of this kind of tortious liability.

[192] See B. Haar. 'Civil Liability of Credit Rating Agencies after CRA 3– Regulatory All-or-Nothing Approaches Between Immunity and Over-Deterrence', University of Oslo Faculty of Law Legal Studies Research Paper Series No. 2013-02.
[193] See M. Lehmann, "Civil liability of rating agencies—an insipid sprout from Brussels", 60.

6.4. The Regulation on OTC derivatives ('EMIR')

The EMIR lays down a set of detailed organizational, prudential and business conduct rules for the counterparties and central counterparties.[194] Besides these rules, an interesting feature of this Regulation is that it expressly provides that the infringement of the rules of Title III (including clearing, reporting and risk mitigation obligations, thus excluding the CCP's conduct of business rules vis-à-vis its clearing members) shall not affect the validity of an OTC derivative contract or the possibility for the parties to enforce the provisions of an OTC derivative contract. In addition to this, an infringement of these rules shall not give rise to any right to compensation from a party to an OTC derivative contract (Article 12(3)).

Although the EMIR does not explain the rationale for these provions, which were added to the Commission proposal during the legislative process,[195] such a limitation of private law rights could be explained by the need of preserving the efficiency of the OTC markets and mitigating the systemic risk due to private litigation.

7. The private enforcement of EU financial regulation: From autonomy to functionalism

The design of rights, remedies and procedures has remarkable implications on the role and functions of private law in financial transactions. Leaving for the moment aside the questions regarding the legitimacy of these regulatory interventions, as well as their impact on the enforcement of EU financial regulatory standards,[196] it is important to underline that the increasing intervention of the EU into private law and enforcement inevitably determines a restriction of the procedural and remedial autonomy of Member States and the consequent instrumentalization of the private autonomy of market participants.

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[194] Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories ('EMIR') OJ L 201/1 (2012).
[195] European Commission. Proposal for a Reuglation of the European Parliament and of the Council on OTC derivatives, central counterparties and trade repositories. Brussels, 15.9.2010 COM(2010) 484 final.
[196] See Chapter 8, below.

However, a distinctive feature of this instrumentalization is that it seems driven by different, and partly, contrasting rationales. The MiFID II, departing from the model of the MiFID I predominatly on process-oriented mechanisms for protection, lays down new remedial and procedural rules that aim to empower the retail client in order to ensure his or her effective protection and access to justice. Although the MiFID II cannot be regarded as a traditional contract law instrument, because it does not clarify the effect of its conduct rules between the contracting parties, its emphasis on the effective protection and compensation of retail clients suggests that national private law should grant a remedy for the breach of its rules.[197]

However, the PRIIPs, CRA Regulation and EMIR, whilst empowering retail clients with EU-based remedies, also introduce limitations and restrictions that may limit the actionability of these remedies under national law (particularly because these restrictions are based on Regulations). The EU legislator did not expressly spell out the rationale for this regulation of private enforcement but such rationale can be found in the fear that excessive levels of litigation undermine the efficiency of financial markets and even finanicial stability. It nevertheless remains to be seen how these two emerging rationales of private law (i.e. investor protection and financial stability) can co-exist in the EU post-crisis regulatory framework and how these will be affecting the interpretation of the national, traditional contract law.

Intermediate conclusion

The analysis of the substantive level of contract governance has shown how the externally-imposed regulatory regimes (conduct regulation, product regulation, private law) have changed after the global financial crisis. Two remarkable trends should be underlined: the infusion of investor protection regulation with financial stability or macro-prudential objectives and the introduction of new, outcome-oriented mechanisms of contract governance in retail transactions. Both of these trends indicate an increasing instrumentalization of traditional private law to achieve regualtory objectives. In this respect, whilst the finding that private law can

[197] See Chapter 8, below.

be used to regulate markets is certainly not new, what is new is the 'direction' of instrumentalization, namely the need to ensure the stability of the financial system. This change requires further investigation in order to better understand its conceptual and legal foundations as well as its limits.[198]

The analysis of the substantive level of governance, however, could not explain *per se* whether and to what extent EU conduct regulation can affect the interpretation and enforcement of national private laws. This is because the effectiveness of the EU investor protection regimes is determined not only by the choices of the EU regulators but also by the choices of the EU and national enforcement mechanisms which are responsible for the implementation of EU law. To this purpose, it is necessary to take a closer look at the enforcement design of retail financial transactions and analyze how different enforcement mechanisms in different EU countries have applied and interpreted the EU investor protection regulation before and after the financial crisis.

[198] See Chapters 7 and 8, below.

Part II: THE ENFORCEMENT DESIGN OF RETAIL FINANCIAL TRANSACTIONS

Setting the scene

The second part of the thesis examines the enforcement level of governance of retail financial transactions in the EU. It focusses on how supervisory authorities (Chapter 4), ADR mechanisms (Chapter 5), and national courts (Chapter 6), in Italy, Spain, France and the UK, have enforced, or ensured the effectiveness of EU investor protection regulation (in particular, conduct of business rules) in order to identify convergent and divergent trends among these national experiences before and after the global financial crisis.

Chapter 4 – THE IMPACT OF FINANCIAL SUPERVISION ON THE GOVERNANCE OF FINANCIAL TRANSACTIONS

1. Financial supervision in the EU financial markets

The term 'supervision' comes from the Latin words *super* and *vision,* which literally mean "to view from above", and indicates the monitoring of the activity of a person or entity in a particular field of business.[199] In the financial sector, 'supervision' is the task mandated to public authorities, independent from central and regional governaments, which consists in assessing the supervised entities' compliance with regualtory requirements and taking actions to ensure adherence to the rules and prevent their future breach.[200]

Member States set up supervisory authorities between the 1960s and the 1980s to protect the integrity of financial markets and to foster competition among market participants, i.e. by removing the residual powers of central governments to interfere,

[199] See I. Angeloni. 'Rethinking Banking Supervision and the SSM Perspective'. Speech by Ignazio Angeloni, Member of the Supervisory Board of the European Central Bank, Conference on "The new financial architecture in the Eurozone", European University Institute, Fiesole, 23 April 2015, p. 10.

[200] Unlike enforcement, the supervisory activity does not involve the imposition of sanctions for the actual breach of regulatory requirements or administrative decisions. The distinction between supervision and enforcement activity is however difficult to draw not only because the same authority can be entrusted with both functions but also because supervisory actions can have a sanctioning function.

especially through the granting/withdrawal of banking licenses, with the structure of capital markets. To this purpose, national legislation conferred on these authorities traditional administrative/executive powers (e.g. request of information, inspections, sanctioning) and regulatory (or legislative) powers, previously exercised by private, self-regulatory organisations.[201]

With the creation of the CESR in 2001 and the other Lamfallussy Committees, the EU introduced some elements of convergence in the national supervision but without transferring any power from the national to the EU level. This transfer has taken place in 2010, after the global financial crisis, when the Committees were replaced by the European System of Financial Supervision (ESFS), an integrated network composed by the NCAs, the ESAs, the ESAs Joint Committee and the European Systemic Risk Board (ESRB).[202] In 2013 and 2014 the Single Supervisory Mechanism (SSM)[203], composed of the the NCAs and the European Central Bank (ECB), and the Single Resolution Mechanism (SRM)[204], composed of the national resolution authorities (NRAs) and the Single Resolution Board (SRB), were established.

This chapter seeks to explain how the increasing 'pluralization of the EU administration'[205] can affect the substantive and procedural governance of financial contracts. To this purpose, the chapter will consider both the direct effects of supervisory acts, i.e. the capability of a supervisory act to create, suspend or terminate a contractual right, and their 'indirect effects', i.e. the capability of a supervisory act to influence the interpretation and application of the legislation applicable to the transaction.

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[201] See D. Kelemen. *Eurolegalism. The Transformation of Law and Regulation in the European Union*, Boston: Harvard University Press, 2012, p. 100 .

[202] Regulation (EU) No 1092/2010 of the European Parliament and of the Council of 24 November 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board O.J. L 331/1 (2010).

[203] Council Regulation (EU) No 1024/2013 of 15 October 2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions OJ L 287/63 (2013).

[204] Regulation (EU) No 806/2014 of the European Parliament and of the Council of 15 July 2014 establishing uniform rules and a uniform procedure for the resolution of credit institutions and certain investment firms in the framework of a Single Resolution Mechanism and a Single Resolution Fund and amending Regulation (EU) No 1093/2010 OJ L 225/1 (2014).

[205] H. C. H. Hofmann. 'European Administration: Nature and Developments of a Legal and Political Space' in C. Harlow, P. Leino, G. della Cananea (eds.). Research Handbook on EU Administrative Law. Cheltenham: Edward Elgar, 2017, p. 28.

The fact that administrative rule-making and supervision can restrict individual property and contractual rights is not a novelty. National supervisory authorities have intrusive powers to limit and restrict property rights of financial market participants and for this reason they are subject to *ex ante* and *ex post* accountability regimes[206] and their decisions must be amenable of administrative and judicial review.[207]

What is new and significant is that the ESAs (which can only exceptionally affect directly these property rights) could frequently affect the market participants property rights indirectly, namely through their quasi-regulatory and quasi-supervisory powers.[208] The hybrid nature of these powers derives from the need of balancing the respect for the boundaries set down by the Union Courts, in particular in the landmark *Meroni*[209] with that of ensuring the effectiveness of the ESAs mandate.[210] This hybrid nature of the ESAs' powers, however, poses the question of how what extent the ESAs, and in particular, the ESMA can affect the contractual obligations between market participants (direct effect) and/or the interpretation of the contract law applicable to their transactions (indirect effect).

To identify the direct and indirect effects of the ESMA'sacts, this chapter analyses the relevant regulatory and supervisory acts adopted by the ESMA and the Italian, French, Spanish and UK NCAs to fulfil their investor protection mandate. In particular, the comparative analysis will show how different supervisory models (sectoral, twin-peaks) and different powers can shape the contours of property rights and how the

[206] See, in general, K. Alexander. 'The European Central Bank and Banking Supervision: The Regulatory Limits of the Single Supervisory Mechanism' 3 European Company and Financial Review (2016): 487.
[207] In EU law, these rights of defence are granted by Article 22 of the SSM Regulation, Articles 31-33 of the SSM Framework Regulation and Article 41 of the CFR.
[208] See also Y. Svetiev, A. Ottow. 'Financial Supervision in the Interstices Between Private and Public Law', 496–544; O.O. Cherednychenko. 'Public Supervision over Private Relationships: Towards European Supervision Private Law?', 37–68 and F. Della Negra. 'The Effects of the ESMA's Powers on Domestic Contract Law', 139-166.
[209] Cae C-9/56, *Meroni v High Authority of the European Coal and Steel Community*, ECLI:EU:C:1958:7.
[210] See in particular T. Tridimas. 'Financial Supervision and Agency Power: Reflections on ESMA' in N. Shuibhne and L. W. Gormley (eds.), From Single Market to Economic Union, Oxford: Oxford University Press, 2012, p. 56.

action of the ESMA can affect that of the NCAs.

2. Supervising EU financial markets before the crisis: The Lamfallussy Committees

The MiFID I introduced a limited harmonisation of supervisory and enforcement powers (Articles 50 and 51) but did not change the allocation of tasks and powers between EU and NCAs: the NCAs remained exclusively competent to exercise these powers. The first important change towards institutional convergence took place in 2001 and 2003 when the Commission set up the European Securities Committee,[211] the Committe for Securities Regulators (CESR),[212] the Committee of European Banking Supervisors (CEBS) [213] and the the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS).[214]

The CESR, which was originally responsible to advise the Commission for the preparation of draft implementing measures (Level 2 legislation), after the review of the Lamfalussy process, [215] was tasked for ensuring consistent application of Community legislation, through non-binding guidelines, recommendations and standards, and for supervisory convergence, through peer reviews, opinions, trainings, joint inspection teams.[216]

The CESR was composed of high-level representatives from the NCAs and was chaired by chairperson without voting rights; the Committees deliberations were taken, as a

[211] Commission Decision 2001/528/EC of 6 June 2001 establishing the European Securities Committee.
[212] Commission Decision 2001/527/EC of 6 June 2001 establishing the Committee of European Securities Regulators.
[213] Commission Decision 2004/5/EC of 5 November 2003 establishing the Committee of European Banking Supervisors.
[214] Commission Decision 2004/6/EC of 5 November 2003 establishing the Committee of European Insurance and Occupational Pensions Supervisors.
[215] Commission. Communication on the Review of the Lamfalussy process Strengthening supervisory convergence COM(2007) 727 final.
[216] See in more detail the Charter of the Committee of European Securities Regulators. Ref.: CESR/08-375d (the first version of the Charter was adopted in 2006 (CESR 06/289c).

general rule, by consensus.[217]

The CESR's supervisory convergence mandate was limited to the participation to the college of supervisors and to the power to cross-border disputes between NCAs through a non-binding mediation mechanism.[218] Whilst this network structure successfully managed to support the Commission decision-making and to enhance supervisory cooepration,[219] it was ill suited to ensure compliance of NCAs and market participants with EU law.[220] In fact, the lack of binding powers undermined their 'ability to act' and their national-driven governance, weakened their 'will to act'.[221]

3. Supervising EU financial markets after the crisis: The ESFS and the ESMA

3.1. The new institutional context: from convergence to integration

To enhance the ability to act and willingness to act of EU authorities, the EU established the ESFS, which is a "system" composed by the ESAs, the ESRB and the NCAs. The ESFS, therefore, marks a shift from the previous model of coordination (or networking) to a model of integration between NCAs and EU authorities. The underpinning rationale, which has driven also the construction of EU financial regulation, is that integrated institutions can better react to the increasing interconnectedness and integration of financial firms across EU countries.[222] More integration means that, whilst the NCA continue to carry out day-to-day supervision, the EU authorities should become 'supervisors of supervisors'[223] by performng a

[217] Article 14 of the Commission Decision 2009/77/EC of 23 January 2009 establishing the Committee of European Securities Regulators OJ L 25/18, which repealed the Commission Decision 2001/527/EC.
[218] See recital No 12 of Commission Decision 2009/77/EC
[219] For a positive account of this network regulators, see P. Schammo. *EU Prospectus Law. New Perspectives on Regulatory Competition in Securities Markets*, Cambridge: Cambridge University Press, 2011, p. 21; L. Quaglia. 'Financial Sector Committee Governance in the European Union' 30 Journal of European Integration (2008): 567.
[220] See J. De Lariosere., Report. Brussels, 25 February 2009, para 162..
[221] For the concept of 'ability to act' and 'will to act' of supervisors, see IMF. 'The Making of Good Supervision'. May 2010, p. 14. See also A. Turner. 'The Turner Review. A regulatory response to the global banking crisis. March 2009, p. 36 and N. Moloney. *EU Securities and Financial Markets Regulation*, p. 965
[222] See recital no 1 of the ESMA Regulation.
[223] See in particular N. Moloney. *EU Securities and Financial Markets Regulation*, p. 973.

defined number of tasks only to ensure the regulatory and supervisory coordination between the NCAs and the consistent application of EU law with the ultimate objective of ensuring the stability of the EU financial system ("intervention based supervision").[224]

Also the ESRB and ESAs Regulations consider the achievement of this 'financial stability objective' as 'a precondition for the real economy to provide jobs, credit and growth'.[225] The main difference between the ESRB and the ESAs concerns their tasks and powers.[226] The ESAs focus primarily on micro-prudential tasks, namely on identification of trends, potential risks and vulnerabilities stemming from the individual financial firms,[227] whereas the ESRB focusses on macro-prudential tasks, i.e. on the risks arising from the financial system and the macro-economic framework.[228]

3.2. The ESMA's institutional achitecture

Having outlined the objective of the ESAs, it is useful, in order to fully understand the institutional role of the ESMA in the post-crisis era, to briefly illustrate its main differences, and similarities in comparison to the CESR.

The main differences are that (i) the ESAs are Union bodies with legal personality, established under Article 114 of the TFEU, which can be qualified as 'agencies', despite the relevant differences in comparison to pre-existing EU agencies;[229] (ii) the ESAs do

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[224] P. Schammo. 'EU Day-to-Day Supervision or Intervention-based Supervision: Which Way Forward for the European System of Financial Supervision?' 32 Oxford Journal of Legal Studies (2012): 771–797. See also J. De larosière. Report, , p. 57 and D. C. Hardy. 'A European Mandate for Financial Sector Supervisors in the EU' IMF Working Paper WP/09/5. p. 14 recommended that EU financial supervision should focuss on stability saying that extension to other objectives would complicate the task

[225] See Article 1(5) of the ESAs Regulation and Article 3(1) of the ESRB Regulation.

[226] See in particular B. Haar. 'Organizing Regional Systems. The EU Example', in E. Ferran, N. Moloney, N. Payne (eds.), *Oxford Handbook on Financial Regulation*, p. 178 who speaks of 'two tier financial oversight to control systemic risk'.

[227] See recital No 43 of the ESMA Regulation.

[228] See Article 3(1). See, however, Recital No 24 of the ESRB Regulation which stresses the importance of the participation of micro-prudential supervisors in the work of the ESRB.

[229] See for the qulification as agencies: M. Simoncini. 'Legal Boundaries of European Supervisory Authorities in the Financial Markets: Tensions in the Development of True Regulatory Agencies' 34, Yearbook of European Law, (2015), pp. 319–350. See for the differences between ESAs and other EU agencies: Opinion of the Advocate General Jaskiinen in case C‑270/12, UK v European Parliament and

not only aim to ensure convergence but they have a multiple legislative mandate, articulated in objectives, tasks and powers, which has the overriding objective 'to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and businesses' (Article 5(1)); (iii) the ESAs can adopt legal acts of general application (draft regulatory and implementing technical standards) which will be adopted by the Commission in the form of delegated and implementing acts;[230] (iv) the ESAs can adopt, in limited circumstances, legally biding acts addressed to NCAs and market participants (v) the ESAs have the right to participate in supervisory colleges and duties to set agenda and settle disaagreements (v) the majority voting within ESAs with simple majority or qualified majority for most important decision, (vi) the ESAs are assisted by a Board of Appeal (BoA) which is competent for the administrative review of their 'decisions'.

Despite these relevant changes, the ESAs maintain some important similarities with the Lamfallussy 's Committees: (i) the ESAs do not carry out day-to-day supervision but intervene only in enumerated and exceptional circumstances to address decisions to NCAs and market participants ('intervention based supervision'); (ii) although the ESFS comprises also the Joint Committee of the ESAs,[231] the division of competences between the ESAs is based on the distinction between finance, banking and insurance;[232](iii) the ESAs governance, likewise the Committees, but differently from the ECB-SSM, is based on a pure intergovernamental model because only the NCA have voting rights in the Board of Supervisors (Chair does not have voting rights) and therefore, the ESAs cannot, impose 'its' view against the collective view of the national competent authorities;[233] (iv) the ESAs, unlike some NCAs[234] and the ECB-SSM, are

Council, ECLI:EU:C:2013:562, para 24 and T. Tridimas. 'Financial Supervision and Agency Power: Reflections on ESMA', p. 82.

[230] Case C-270/12, UK vs European Parliament and the Council, ECLI:EU:C:2014:18, para 66.

[231] The Joint Committee carries out the tasks of Article 54-57 ESAs Regulation. See, in particular, I.Chiu. 'Power and Accountability in the EU Financial Regulatory Architecture: Examining Inter-Agency Relations, Agency Independence and Accountability' 8 European Journal of Legal Studies (2015): 85.

[232] See V. Colaert. 'European Banking, Securities and Insurance Law: Cutting Through Sectoral Lines?' 52 Common Market Law Review 52 (2015): 1579–1616.

[233] See E. Ferran. 'The Existential Search of the European Banking Authority' 17 European Business

publicly funded (60% contribution from the NCAs and 40% contribution from the EU budget). [235]

3.3. The ESMA's investor protection mandate

The protection of consumers and investors takes up a central role in the ESAs and the ESMA's architecture.

The Commission Proposal for the ESMA Regulation ranked the protection of investor as the second objective of the ESMA, before the stability of the financial system, after the functioning of the internal market.[236] The Parliament, in its first reading, defined the ESMA's objective in much broader terms as "to ensure that the rules applicable to the financial sector are adequately implemented to preserve financial stability and to ensure confidence in the financial system as a whole and sufficient protection for the customers of financial services".[237] At the same time, the Parliament introduced a specific "consumer protection task", which includes also the power to temporarily prohibit or restrict financial financial activities that threaten the orderly functioning and integrity of financial markets or the stability of the financial system.

In its final version, the Regulation maintains this task but introduces a different hierarchy within the objectives.[238] Whereas the ESMA's objective shall be "to protect the public interest by contributing to the short, medium and long-term stability and effectiveness of the financial system, for the Union economy, its citizens and

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Organization Law Review (2016): 290.

[234] The UK FCA is funded by the entities subject to its regulation/supervision (see: FCA, How we raise our fees. July 2013).

[235] Commission. 'Report from the Commission to the European Parliament and Council on the operation of the ESAs and the ESFS' COM (2014) 509, p. 11. The Commission proposes to increase the private funding, through fees and levies.

[236] Article 1(4) of the Commission Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority Brussels, 23.9.2009 COM(2009) 503 final.

[237] EU Parliament. Position at first reading on 22 September 2010 with a view to the adoption of Regulation (EU) No …/2010 of the European Parliament and of the Council establishing a European Supervisory Authority (European Securities and Markets Authority) OJ C 50E/217.

[238] The following provisions quoted in the text refer to the ESMA Regulation, unless otherwise specified.

businesses" (Article 1(5)), the ESMA shall *merely* contribute, *inter alia*, to "enhancing customer protection" (Article 1(5)(f)) (*my emphasis*).

The design of the ESMA architecture is thus illustrative of the balance between the protection of investors objective, emphasized by the Parliament, and the financial stability objective, emphasized by the Council. However, there remains some ambiguity as to the relationship between objectives and tasks.

On the one hand, the ESMA is required to merely contribute to the protection of customer and not to direcly achieve this objective. It could indeed be argued that the 'customer protection' objective ranks after the overriding 'financial stability objective', in the sense that it should be pursued in so far as it does not prejudice finacial stability. On the other, the ESMA has been tasked with a specific consumer protection mandate whose scope, however, remains unclear.[239]

This is because the Regulation names the task of Article 9(1) as 'consumer protection' (Article 9(1)) but it also confers on the ESMA the task of 'fostering investor protection' (Article 8(1)(h)), whilst indicating, as mentioned, as objective that of enhancing 'customer protection' (Article 1(5)(f).[240]

Legally speaking, the notions of consumer, investor and customers are very different. The notion of consumer in EU law is the most restrictive because it comprises only natural persons, who act outside their trade, business or profession.[241] The notions of client (which is used by the MiFID but strangely not by the ESMA Regulation), investor and customer refer, broadly, to the recipient of financial services (both natural and legal persons) and aim to capture the fragmentated and variegated dimension of 'consumption' in the regulated markets where goods and services are addressed to

[239] See G. Deipenbrock. '*The European Securities and Markets Authority and Its Regulatory Mission: A Plea for Steering a Middle Course'* in M. Andenas, G. Deipenbrock (eds.). *Regulating and Supervising European Financial Markets*, p. 18 who argues that the distinction between tasks and objectives is not dogmatically clear.

[240] Article 1(5)(f) of the ESMA Regulation in the italian, french, spanish and german version it refers to consumer (consumatore, consommateurs, consumidor, verbraucher).

[241] At the national level, legislation usually refers to 'investor' (see Article 5 of Italian TUF; Article L214-23 E code monetaire et financiere). The UK FSMA 2000 refers to the notion of consumer (Article 5(1)) but also specifies that the FCA shall perform its consumer protection objective taking into account the general principle that consumers should take responsibility for their decisions.

both end users (traditional consumers) and other intermediaries.[242] Understanding whether the use of the term 'consumer' aims to restrict the ESMA's mandate to sole natural persons or it simply aims to indicate a consumer protection approach in supervision is of crucial practical and theoretical importance.

It is argued that the use of the narrowest notion of consumer does not aim to restrict the ESMA tasks and powers to the natural persons only. First, because from a systematic perspective, it is worth noting that the the MiFID II[243] uses the term 'consumer' in order to emphasise the need of enhanced protection for the vulnerable retail clients without the intention of restring the scope of this statutory task the non-retail investors. Second, because the ESMA can act, irrespective of the nature of the recipient of financial services (natural and legal person), within the scope of the legislative acts mentioned by Article 1(2) and also in relation to issues not directly covered by these acts, in order to ensuring their effective and consistent application.[244]

This reading is also confirmed by the ESMA's activity and supervisory practices. Whilst sometimes referring to its mandate as a consumer protection one,[245] the ESMA has generally referred its legal acts to the broader category of retail clients,[246] and established a permanent working group to promote common practices in investor protection and an Investor Protection and Intermediaries Standing Committee, thus showing the intention to cover both the demand-side and the offer-side of financial

[242] H.-W. Micklitz. 'Do Consumers and Businesses Need a New Architecture of Consumer Law? A thought-provoking impulse'. EUI Working Papers LAW 2012/23 DEPARTMENT OF LAW.
[243] See recitals No 66, 77, 156, 177; Art. 24(6), 74(2) and 75(1) of the MiFID II.
[244] See ESMA. Opinion on Investment-based crowdfunding. 18 December 2014 | ESMA/2014/1378. ESMA has mentioned that the Directive 2005/29/EC on unfair commercial practices directive and the Directive 1993/13/EEC on unfair contract terms are among the EU legal acts which can be potentially applicable to this market practice to mitigate some of its risks.
[245] ESMA, Strategic Orientation 2016-2020. 15 June 2015 | ESMA/2015/935, p. 6 and ESMA, Work Programme 2017. Septber 2016 | ESMA/2016/1419, p. 5.
[246] ESMA. Guidelines on cross-selling practices. 22 December 2015 | ESMA/2015/1861, p. 7. After the public consultation on the guidelines on cross-selling, ESMA replaced the references to customer, with references to clients. For express references to retail clients, see ESMA, CFDs, binary options and other speculative products is expressly targeted to retail clients. 25 July 2016ESMA/2016/1166.

markets.[247] Howewer, depending on the context, ESMA has also referred to investors[248], institutional investors[249], and complainant[250].

3.4. The ESMA's powers

Although the ESMA has specific 'consumer protection'-related powers to carry out its consumer protection mandate, all its conferred powers can be used in order to perform its consumer protection task. Taking into account their purpose, these powers can be grouped into four main categories:[251]

- Quasi-regulatory powers through draft regulatory and implementing technical standards, guidelines and, recommendations;
- Indirect supervisory powers through the decisions addressed to NCAs under Articles 17-19 as well as opinions;
- Supervisory convergence powers through peer reviews, Q&A and supervisory colleges;
- Direct supervisory powers, through decisions addressed to financial market participants under Articles 17-19, the ESMA day-to-day supervision and enforcement powers over credit rating agencies and, trade repositories and product intervention powers.

The following sections identify the legal boundaries of the ESMA's powers and outline the most relevant acts already adopted by the ESMA in order to identify their potential direct and indirect effects on the property rights of financial market participants.

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[247] See CNMV, Annual Report 2015, p. 218.
[248] See ESMA Stakeholder Group. 'Advice to ESMA. Investor Protection Aspects of the Consultation Paper on MiFID II and MiFIR', p. 29.
[249] See ESMA. Potential Risks Associated with Investing in Contingent Convertible Instruments. Statement. 31 July 2014 ESMA/2014/944 (referring to institutional investors).
[250] Joint Guidelines on complaints-handling for the securities (ESMA) and banking (EBA) sectors. 13 June 2014 JC 2014 43.
[251] See for this classification N. Moloney. *EU Securities and Markets Regulation*, p. 976 ss.

1. Guidelines

The ESMA guidelines, like the CESR's ones,[252] aim to ensure the uniform and consistent application of EU financial regulation (Article 16(1)).[253] The most important and controversial issue concerns the procedural and substantive effects of ESMA's guidelines.

From a procedural perspective, the ESMA's guidelines, differently from the CESR's ones, require the NCAs and market's participants to make every effort to comply with the guidelines and, if required by that guideline, the financial market participants shall report, in a clear and detailed way, whether they comply with that guideline or recommendation (Article 16(3)). These 'procedural obligations', imposed on the addressee,[254] "harden" the "soft-law" nature, which has been traditionally attributed to guidelines issued by EU institutions and agencies,[255] and can trigger an the enforcement procedure provided for by Article 17 of the ESMA Regulation in the case of non-compliance.[256]

From a substantive point of view, the ESMA Regulation does not expressly state that guidelines are non binding.[257] To be sure, the ESMA in its guidelines on MiFID I

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[252] See in particular T.M.J. Möllers. 'Sources of Law in European Securities Regulation – Effective Regulation, Soft Law and Legal Taxonomy from Lamfalussy to de Larosière' 11 European Business Organization Law Review (2010): 379 – 407.

[253] To date ESMA has adopted a total number of 22 guidelines (see ESMA list updated at 29.11.2016: https://www.esma.europa.eu/sites/default/files/library/esma_guidelines.pdfESMA has already issued 6 guidelines on MiFID I, all of them of its own initiative, based on Article 16 of ESMA Regulation and 7 guidelines on MiFID II (three under consultation), four of them of its own initiative and three based on Level 1 provisions (e.g. Article 24(11) and 25(10) MiFID II).

[254] It remains doubtful, instead, whether the procedures for adoption of guidelines ensure the principles of accountability of the ESAs. See in particular E. Chiti. 'European Agencies' Rulemaking: Powers, Procedures and Assessment' 19 European Law Journal (2013): 106.

[255] On the legal nature of guidelines see particular T. Tridimas. 'Financial Supervision and Agency Power: Reflections on ESMA', p. 71; N. Moloney. *EU Securities and Markets Regulation*, p. 929; F. Terpan. 'Soft Law in the European Union—The Changing Nature of EU Law' 21 European Law Journal (2015): 68. For a case where guidelines shall be respected by their addressee see Article 14.3. of the Protocol (No 4) on the Statute of the European System of Central Banks and of the ECB OJ C 326/230 (2012).

[256] See Commission. *Report to the European Parliament and the Council on the evaluation of the Regulation (EU) No 236/2012 on short selling and certain aspects of credit default swaps*, COM(2013) 885 final.

[257] See instead Article 3 of the Commission Decision 2009/77/EC of 23 January 2009 establishing the Committee of European Securities Regulators, p. 18 which establishes that the CESR guidelines are non-binding. Notably, the ESMA Regulation expressly uses the notion of 'binding' or 'non-binding' legal acts with regard to mediation (see Articles 21(4) and 31).

suitability requirements pinpoints that 'Guidelines do not reflect *absolute obligations*. For this reason, the word 'should' is often used. However, the words 'must' or 'are required' are used when describing a MiFID requirement'.[258] However, the distinction between 'innovative' and 'descriptive' guidelines is blurred in practice especially when guidelines specify or interpret general requirements (fair dealing) included in Level 1 legislation.[259]

Also, even if guidelines describe existing requirements, they can produce 'substantive' effects for both the EU authority and their addressees. In particular, according to the Union courts, guidelines, albeit non legally binding, can nonetheless provide a helpful reference point for a judicial assessment.[260] In addition, guidelines are "rules of practice from which limit the discretion of the EU insitution or agency which cannot depart from those rules under pain of being found, where appropriate, to be in breach of the general principles of law, such as equal treatment or the protection of legitimate expectations".[261] An important corollary – affirmed by the CJEU with regard to the Commission guidelines for the calculation of fines – is that guidelines, even if they cannot constitute the legal basis of the decision, they may none the less form the subject-matter of an objection of illegality under Article 277 of the TFEU (ex Article 241 TEC).[262] It follows from this case law that guidelines should be relied upon by national courts when interpreting EU conduct regulation (horizontal indirect effects), as transposed by national law, and can be used by the EU and national authorities as a

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[258] ESMA. Guidelines on certain aspects of the MiFID suitability requirements. 21 August 2012 ESMA/2012/387

[259] See ESMA. Guidelines on ETFs and other UCITS issues. 18 December 2012, ESMA/2012/832 where ESMA imposes to the UCITS' managers duties to conduct that have not been laid down in the relevant UCITS legislation (para 22, 37, 43) and ESMA. Guidelines on complex debt instruments and structured deposits. 04 February 2016 ESMA 2015/1787 under MiFID II set criteria for the assessment of debt instruments and structured deposits which fall under Article 25(4)(a)(ii) of the MiFID II and therefore cannot be distributed through an execution regime.

[260] See C‑223/01, *AstraZeneca* ECLI:EU:C:2003:546, para 28 and case C‑628/13, *Jean-Bernard Lafonta* ECLI:EU:C:2015:162, para 41. See also the Opinion of Advocate General Wahl in case C‑104/13, *AS "Olainfarm"* ECLI:EU:C:2014:342, para 39.

[261] Joined Cases C-189/02 P, C-202/02 P, C‑205/02 P to C‑208/02 P and C‑213/02 P, *Dansk Rørindustri A/S*, ECLI:EU:C:2005:408, para 209-211. See also case C-526/14, *Kotnik and Others v Državni zbor Republike Slovenije*, ECLI:EU:C:2016:570, para 40. See also ESAs Board of Appeal, *SV Capital OU v. EBA of* 24 June 2013. BoA 2014–C1–02, para 56.

[262] Joined Cases C-189/02 P, C-202/02 P, C‑205/02 P to C‑208/02 P and C‑213/02 P, *Dansk Rørindustri A/S*, para 212.

yardstick to take legally binding measures (product intervention) addressed to market participants.

2. Draft technical standards

The most important quasi-regulatory power of the ESAs is the adoption draft (regulatory and implementing) technical standards (DTS) which can be endorsed by the Commission by means of delegated or implementing acts (in the form of decisions or regulations) pursuant to Articles 290 and 291 of the TFEU.[263] Although the DTS increased the 'regulatory capacity' of the ESAs, in comparison to the former Lamfallussy Committees, they do not represent fully fledged regulatory or legislative powers.[264]

The Commission cannot change the content of a draft regulatory/implementing technical standard prepared by the Authority without prior coordination with the Authority.[265] DTS shall be technical and shall not imply strategic decisions or policy choices.[266] However, the boundaries between purely tecnical and policy choices are very difficult to draw and often depend on how important a certain issue is for political authorities (i.e. a decision perceived to be uncontentious is accepted as being technical).[267]

Can the provisions of the the DTS, be invoked by individuals against the firms before their endorsement by the Commission, given that, in practice, many months can pass

[263] The Board of Supervisors shall adopt the DTS on the basis of a qualified majority of its members (Art. 44 (1) ESMA Regulation).

[264] See on the legal nature of DTS and difference between implementing and regulatory standards: T. Tridimas. 'Financial Supervision and Agency Power: Reflections on ESMA', in N. Shuibhne and L. W. Gormley (eds.). From Single Market to Economic Union, p. 70.

[265] Seven out of eight regulatory standards on the MiFID have been endorsed by the Commission without amendments. Two implementing standards have been endorsed by the Commission without amendments. The Commission rejected the draft implementing technical standards to amend Implementing Regulation (EU) No 1247/2012 on the format and frequency of trade reports to trade repositories under Regulation (EU) No 648/2012, C(2014) 335 final.

[266] Arts. 10 (1) and 15 (1) ESMA Regulation. For the difference between regulatory and technical standards see N. Moloney, 2014, p. 922.

[267] L. Quaglia. 'Financial Sector Committee Governance in the European Union', 572.

between the ESAs adoption and the Commission final endorsement?[268] In this regard, the Advocate General Jaskiinen, in his opinion on the 'bonus-cap case', concluded that "draft measures have no legal effects going beyond the internal decision-making process of the Commission […] and thus 'draft measures proposed by the EBA, or any other EU agency for that matter, are in themselves incapable of harmonizing any national provisions or affecting the rights and obligations of individuals". [269] However, despite their provisional nature, it could be argued that DTS should at least produce the substantive effects of guidelines. If guidelines, which are not formally speaking legally binding, product that effects, *a fortiori,* the DTS which are meant to be binding, if the Commission does not object them, should produce similar effects for the EU authority and their addressee.

5. Indirect supervisory acts

The ESMA can address legally binding decisions to NCAs in order to enforce EU law (Article 17), to facilitate and coordinate any actions undertaken by the NCAs in cases of emergency situations (Article 18) and to settle disagreements between competent authorities in cross-border situations (Article 19). Although the detail analysis of these powers would trascend the scope of this chapter,[270] it should be noted that the use of these indirect supervisory powers has been limited. Until now the ESAs have detected only one breach of EU law committed by the NCAs.[271] In several occasions they have dismissed, by way of informal letters[272] or decisions[273], the requests of private

[268] The ESMA DTS on MiFID II investor protection related rules, a first batch of DTS was submitted on 28/9/2015 and endorsed on 8/6/2016 and a second batch was submitted on 29/6/2015 and endorsed on 14/07/2016. See ESMA list of technical standards updated on 28/11/2016 (https://www.esma.europa.eu/sites/default/files/library/technical_standards.pdf)

[269] Opinion of the Advocate General Jääskinen, in case C‑507/13, *UK v European Parliament and Council of the European Union*, ECLI:EU:C:2014:2394, para 64.

[270] See N. Moloney. EU Securities and Markets Regulation, p. 982.

[271] EBA, EBA/REC/2014/02 17 October 2014 Recommendation to the Bulgarian National Bank and Bulgarian Deposit Insurance Fund on action necessary to comply with Directive 94/19/EC.

[272] https://www.esma.europa.eu/sites/default/files/library/2015/11/boa_2015_-_001_decision_onix_v_eiopa.pdf and https://www.esma.europa.eu/sites/default/files/library/boa_2016_-_001_decision_kluge_v_eba.pdf

[273] https://www.esma.europa.eu/sites/default/files/library/2015/11/boa_2014-c1-02_decision_0.pdf and

investors to open investigations about alleged breach by NCAs of applicable Union law. Against these acts five appeals have been brought before the ESAs BoA and one has been upheld[274] and four rejected because inadmissible[275] or unfounded[276].

6. Direct supervisory powers

Together with the indirect supervisory powers, ESMA has been vested with direct supervisory powers, which enable the Authority to address legally binding decisions to market participants. These powers reflect the 'intervention-based' supervisory model of the ESAs and mark the most important difference fromthe Committees and the other EU agencies.[277] Direct supervisory powers can be divided into cross-sectoral and sectoral powers.

A) Cross-sectoral powers

In exceptional circumstances, and subject to strict procedural requirements, the ESMA can use the powers laid down in Articles 17-19, in all sectors of their activity, to address legally binding decisions to financial market participants.

A particular attention, for the repercussions it may have on the private enforcement of conduct regulation and the protection of investors, deserves the enforcement power laid down in Article 17. In fact, the absence of enforcement actions by the NCA could weaken the protection of investors before national courts because financial firms could

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[274] https://www.esma.europa.eu/sites/default/files/library/2015/11/boa_2013-008_board_of_appeal_sv_capital_ou_vs_eba_u_decision.pdf

[275] See https://www.esma.europa.eu/sites/default/files/library/2015/11/boa_2014_05_decision_ipe_sprl_vs_esma_2.pdf; https://www.esma.europa.eu/sites/default/files/library/2015/11/boa_2015_-_001_decision_onix_v_eiopa.pdf; and https://www.esma.europa.eu/sites/default/files/library/boa_2016_-_001_decision_kluge_v_eba.pdf

[276] https://www.esma.europa.eu/sites/default/files/library/2015/11/boa_2014-c1-02_decision_0.pdf

[277] For a comparison between the EU agencies and the ESAs see Advocate General Jääskinen, opinion in case C-270/12, *UK* v. *Parliament and Council*, para 24; E. Chiti. 'European Agencies' Rulemaking: Powers, Procedures and Assessment' 110; T. Tridimas. 'Financial Supervision and Agency Power: Reflections on ESMA'.

argue that the inaction of the NCA confirms that there is no breach.[278]

However, the BoA of the ESAs has so far upheld the decisions of the EBA and the ESMA not to take action for the inaction of the NCA, by arguing that the ESAs have a discretionary power on whether to open the investigation for the breach of EU law and that this power cannot be used by ESAs to conduct direct supervision.[279]

Also the Union Courts have supported the 'last resort' nature of the Article 17 and its public-enforcement rationale. In particular, in *SV Capital OÜ v EBA*[280] the CJEU, upholding the judgment of the General Court, dismissed the appeals of SV Capital against the EBA decision to refuse to investigate a breach fo EU law and the BoA's decision confirming that decision. The CJEU underlined that the request for investigation of breach of EU committed by competent authorities can be submitted only by one or more competent authorities, the European Parliament, the Council, the Commission or the Securities and Markets Stakeholder Group. A private investor is therefore not entitled to request such investigation.[281] In the recent *Onix Asigurări SA v EIOPA*, the General Court emphasised that the objective of EIOPA (but the same reasoning could apply, by analogy, to the ESMA and EBA) is to ensure financial stability and that Article 17 aims to contributing to achieving financial stability and does not aim "to provide individual protection or redress in disputes between a natural or legal person and a competent authority at the national level".[282]

Critically, these judgments show that the financial stability driven architecture might reduce excessively the recourse to Article 17 and could also down-play the importance of this power for the ESMA's fulfillment of its 'consumer protection'.[283]

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[278] See, similarly, the applicant's argument in BoA, Investor Protection Europe sprl v ESMA (BoA 2014 05), in para 32.

[279] See the BoA in SV Capital OÜ v European Banking Authority (BoA 2013 - 008) at para 30 and BoA, Investor Protection Europe sprl v ESMA (BoA 2014 05), in para 32. Case T‑660/14,, SV Capital v ABE, EU:T:2015:608, paragraph 47 and Case T‑590/15, Onix Asigurări SA v EIOPA, ECLI:EU:T:2016:374, para 53.

[280] Case C-577/15 P, *SV Capital OÜ v EBA,* ECLI:EU:C:2016:947.

[281] Case C-577/15 P, *SV Capital OÜ v EBA,* para 39-41.

[282] Case T‑590/15, *Onix Asigurări SA v EIOPA*, ECLI:EU:T:2016:374, para 55.

[283] In 2015, the EBA handled 24 formal complaints received directly from individuals or legal persons of which most concerned a variety of consumer protection issues. In most of the cases EBA advised the applicants to file their complaints with the most suitable EU or NCA. EBA. Annual Report 2015. p 14.

B) Sectoral powers

The ESMA has also direct, or typical supervisory powers in specific sectors. It is not only exclusively competent for the supervision of Credit Rating Agencies (Arts. 14-17 and Arts. 21-25 of the CRA Regulation) and trade repositories (Arts. 55-59 and Arts. 60-74 of the EMIR) but it can adopt direct supervisory acts to restrict or prohibit the distribution of certain financial products (product intervention).
The ESMA Regulation empowers the Authority to temporarily prohibit or restrict certain financial activities that threaten the orderly functioning and integrity of financial markets or the financial stability of the Union, under specific conditions (Article 9(5)). However, Article 9 powers can be exercised only if specified in the sectorial legislative acts referred to in Article 1(2) or when the Council declares the existence of an emergency situation (Article 18 (2)).[284] The practical relevance of this provision is limited by the fact that ESMA can take product intervention powers on the basis of the MiFIR or the short-selling regulation.

Until now, however, the ESAs have not yet adopted any product' restrictive measures. The reason is threefold. First, the more the regulatory involvement in product regulation, the higher the risks associated with moral hazard. The risks are all the greater for precautionary measures since investors may believe that every product which has been "checked" by the regulator is safe.[285] Second, restrictive measures could alter the supply-side of the market and increase the cost of products for the end-clients.[286] Third, the adoption of product restrictive measure requires a day-to-day knowledge of the firm, its business model and its distribution practices. Without such a supervisory knowledge, it could be very difficult, in practice, for the ESAs to take action without incurring in legal and economic risks. In addition to this, many NCAs have already adopted several product intervention measures and there is a need for the

[284] See Commission. Report to the Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS), p. 8.
[285] See IOSCO. Regulation of Retail Structured Products Final Report, p. 21.
[286] See FSA. The FCA's use of temporary product intervention rules. March 2013, p. 20.

ESMA to assess the impact of these measures on the markets before taking more intrusive actions.[287]

Also for these reasons, the ESAs have so far resorted to the warnings under Article 9 (3) of the ESAs Regulations in relation to certain financial products and practices which pose a serious threat to investor protection. Although warnings do not restrict in any case the distribution of financial products, they can drive the supervisory action of NCAs in specific circumstances and also anticipate to the market potential upcomin product's restrictions.

8. Supervisory convergence

In order to develop the 'supervisory handbook', i.e. a convergent supervisory practices, the ESMA can use a wide range of tools, including the participation to supervisory colleges, stress testing exercises, opinions and peer reviews, and Q&A (Article 29(3)).

With regard to the colleges, ESMA, unlike the Committees, shall participate in the activities of the colleges, including on-site examinations (Article 21(2)), and shall lead in ensuring a consistent and coherent functioning of colleges of supervisors. In addition, ESMA has 'a legally binding mediation role' to resolve disputes between competent authorities in accordance with the procedure set out in Article 19. Despite these legislative improvements, the European Court of Auditors and the Mazars Report noted that, in practice, EBA's impact on supervisory convergence through the colleges has been limited as it is not responsible for organising the colleges (e.g. setting the agenda) and cannot formally participate in their decision-making.[288]

To assess the systemic risk posed by key financial market participants the ESAs may

[287] ESMA Stakeholder group. Own initiative report on product intervention under MiFIR. 16 June 2017 ESMA22-106-264, 8.
[288] See European Court of Auditors. European banking supervision taking shape — EBA and its changing context, p. 28 and Mazars Report, Review of the New European System of Financial Supervision (ESFS). October 2013, IP/A/ECON/ST/2012-23, PE 507.446, p. 65.

also initiate and coordinate Union-wide stress tests in (Article 21(2) and 32).[289] The EBA EU-wide stress test aims to give to supervisory authorities a common framework to compare and analyse large EU banking groups without containing a pass fail threshold.[290] However, even if stress tests are not supervisory decisions nor regulatory acts, they could produce relevant legal effects especially in the context of crisis situations.[291] According to the BRRD and SRM Regulation, the pre-condition for the use of the extraordinary public support to credit institutions,[292] is that a Union or SSM-wide stress test identified a capital shortfall confirmed by the competent supervisory authority.[293]

Opinions aim to foster supervisory convergence in relation to a specific market practice (e.g. crowfunding) or financial product (e.g. product governance)[294] but can also provide valuable inputs to the law-makers and supervisors. Similarly, the peer review tool is a fundamental instrument to asses the effectiveness and the degree of convergence of enforcement of the provisions adopted in the implementation of Union law (Art. 30 (2) (d)), also because peer-review can be taken into to issue guidelines and recommendations and developing draft regulatory technical or implementing technical standards (Article 30 (3)). ESMA has shown the willingness not to limit the peer review to the mapping of different practices (as the CESR did in the past) but to use it to assess whether and to what extent the NCAs implement EU law in an effective

[289] EBA conducted the EU-wide stress test in 2011, 2014 and 2016. The ESMA conducted a stress test on CCP in 2015.

[290] EBA, Stress test 2016. Report, p. 3. The EBA stress test should not be confused with the comprehensive assessments carried out (in 2014 and 2015) by the ECB, which include both an asset quality review (AQR) and a stress test, performed in close cooperation with the EBA, on significant credit institutions and other institutions in exceptional circumstances. See for more details: https://www.bankingsupervision.europa.eu/banking/comprehensive/html/index.en.html

[291] See E. Ferran. 'The Existential Search of the European Banking Authority', 312.

[292] This extraordinary public support excludes the status of 'failing or likely to fail' under Article 18(4)(d)(3) and therefore prevents the credit institution from entering in resolution.

[293] Article 18(4)(d)(3) is the legal basis of the Italian Law Decree of 23 dicembre 2016, n. 237, which sets urgent measures for the protection of savings in banking sector issued, *inter alia*, to remedy the crisis of the Italian significant credit institution Monte dei Paschi di Siena.

[294] ESMA. 'Opinion on MiFID practices for firms selling complex products'. 7 February 2014 ESMA/2014/146.

way.[295] ESMA has conducted two peer reviews on the MiFID I. In the peer review on the level of compliance of the NCAs with the MiFID I best execution rules, ESMA concluded that "the level of implementation of best execution provisions, as well the level of convergence in the general supervisory practices by the competent authorities, is relatively low". In the peer review on the MiFID conduct of business rules laid down in Article 19 of MiFID I, conducted between 1 January 2010 to 30 June 2012 ESMA recommended NCAs improve their oversight on firms' product governance arrangements and to verify the firm's effective compliance with MiFID I conduct rules. The ESMA stressed that compliance with such rules cannot be limited by the delivery of generic standardised information sheet but has to be concrete and tailored on the client.[296] Remarkably, in a follow-up of this peer review, the ESMA warned against the potential shortcomings of a risk-based approach to supervision, underlinying that while such an approach can naturally fit with the supervision of MiFID conduct of business rules, it nevertheless needs to be able to take into account signals on potential breaches by firms of their MiFID obligations. [297]

Finally, the Q&A, which can also be converted into guidelines or recommendation, has become a valuable practice-driven tool for strengthening the supervisory convergence and influencing the conduct supervision of NCAs. Whilst EBA has developed a comprehensive Q&A on the single rule book, the ESMA Q&A focusses on investor protection-related issues such as MiFID I, MiFID II[298] and the distribution of CFDs and other speculative products (binary options and rolling spot forex) to retail clients. The detail and granularity of Q&A poses the issue of their legal effects vis-à-vis market participants. Although Q&A are not legally binding and are not subject to a 'comply or explain' obligation, the EBA stated that 'their application will be rigorously scrutinised

[295] N. Moloney. 'Institutional Governance and Capital Markets Union: Incrementalism or a "Big Bang"?' 2 European Company and Financial Review (2016): 418.
[296] ESMA, Peer review on MiFID Conduct of Business - fair, clear and not misleading information. 11 December 2014 ESMA/2014/1485.
[297] ESMA. Follow-up Report to the Peer Review on MiFID Conduct of Business rules relating to fair, clear and not misleading informatio. 18 May 2017. ESMA/42-113-627.
[298] ESMA, *Questions and Answers On MiFID II and MiFIR investor protection topics*, Date: 16 December 2016 ESMA/2016/1444 ,p. 22.

and challenged by the EBA and national supervisory authorities given their undoubted practical significance to achieve a level-playing field. Peer pressure and market discipline are also expected to play a driving force in ensuring adherence to and compliance with the answers provided in the Q&A process.[299]

In conclusion, despite the challenges linked to the limited budgetary and staffing capacities of ESMA,[300] the new emphasis placed on the 'supervisory convergence' should be positively welcomed to enhance the effectiveness of the single rule book across Member States.

4. The protection of clients in the SSM: The role of the ECB

4.1. The SSM institutional architecture

The Single Supervisory Mechanism (SSM), established in 2013, is the first pillar of the Banking Union. Whilst the ESFS was driven by traditional EU market integration, the rationale of the SSM is to break the vicious bank–sovereign spiral, namely the mutually reinforcing interdependence between the sustainability of public debt on the one hand, and the viability of credit institutions on the other, which was one of the causes of the Euro zone crisis. [301]

The overriding objectives of the SSM are to ensure the safety and soundness of credit institutions and the stability of the financial system within the Union and each Member State (Article 1).[302] To achieve these objectives, the SSM Regulation conferred on the

[299] EBA. Single Rulebook Q&A. Available on http://www.eba.europa.eu/single-rule-book-qa.

[300] The ESMA budget for 2017 is approximately EUR 42 million and the staff includes 225 people. Among them, only 12 will work on consumer protection issues, in comparison to 49 people allocated to supervision of credit rating agencies, 18 to post-trading, 16 to trade repositories supervision, and 15 to market integrity (see ESMA, Work Programme 2017, p. 18 ss.).

[301] See H. Van Rompuy. Towards a Genuine Economic and Monetary Union. Brussels, 26 June 2012 EUCO 120/12, p. 4.

[302] See N. Moloney. 'Institutional Governance and Capital Markets Union: Incrementalism or a "Big Bang"?' p. 398 and N. Moloney, European Banking Union: Assessing its Risks and Resilience' 51 Common Market Law Review (2015), p. 1662; N. Moloney. 'European Banking Union: Assessing its Risks and Resilience' 51 Common Market Law Review (2015): 1662 and F. Allen, E. Carletti, J. Gray (eds.). *The New Financial Architecture in the Eurozone* (Florence: EUI, 2015); T. H. Tröger. 'The Single Supervisory Mechanism – Panacea or Quack Banking Regulation? Preliminary Assessment of the New Regime for the

ECB, on the basis of Article 127(6) of the TFEU,[303] specific prudential supervisory tasks (Artcile 4(1)) and regulatory (Article 4(3)(2), supervisory (Articles 10–17), and enforcement (Article 18) powers. The ECB's exclusive prudential supervisory tasks are implemented within a decentralized framework, where the ECB is responsible for the supervision of significant credit institutions and the NCAs remain responsible for the supervision of less significant institutions of the Euro area.[304]

4.2. The ECB consumer protection mandate: Scope and limitations

The recital No 28 of the SSM Regulation expressly excludes from the ECB tasks the supervision of credit institutions in relation to markets in financial instruments (i.e. MiFID implementation) and the protection of consumers.[305] However, this recital does not prevent the ECB from considering consumer protection issues in the exercise of its exclusive prudential tasks, particularly when such concerns are an indicator of micro-prudential (e.g. capital shortfalls as a result of legal proceedings or fines) or a wider systemic concerns (e.g. misconduct in relation to the issuance of capital instruments previously authorized by the ECB).[306]

In fact, the ECB and the NCAs should assess the conduct risk, which is a sub-category of

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Prudential Supervision of Banks with ECB Involvement' 15 European Business Organization Law Review (2014): 449; B. Wolfers, T. Voland. 'Level the Playing Filed: the new Supervision of Credit Institutions by the European central Bank' *51 Common Market Law Review* 51 (2014): 1463.

[303] See R. D'Ambrosio. 'Meccanismo di Vigilanza Unico' in Enciclopedia del Diritto. Annali, Milano: Giuffrè, 2016, p. 589. For a more open view in favour of the compatibility of SSM Regulation with Article 127(6) TFEU see N. Moloney, European Banking Union: Assessing its Risks and Resilience'p. 1659 and E. Wymeersch. The Single Supervisory Mechanism or "SSM", Part One of the Banking Union. Ghent University Financial Law Institute Working Paper No. 2014-01. For an overview of the different positions: G. Monti, C. A. Petit. 'The Single Supervisory Mechanism: legal fragilities and possible solutions', May 2016, p. 2. WP 2014-01. January 2014, p. 18 ss.

[304] Case T-122/15, Landeskreditbank Baden-Württemberg — Förderbank v European Central Bank (ECB), ECLI:EU:T:2017:337, para 54.

[305] The ECB, member of the EBA BoS, does not have voting rights (Article 40(1)(d) and Article 44(4)), and therefore has a limited capacity to infuence the EBA's regulatory choices, specifically in consumer protection issues. The ECB, however, has the duty to draw the attention of the EBA to the need of submitting to the Commission technical standards in order to amend existing ones (Article 4(3)(4) SSM Regulation).

[306] See also S. Grundmann. 'The banking union translated into (private law) duties: infrastructure and rulebook.', 357 and C. Hadjiemmanuil. 'The Banking Union and Its Implications for Private Law: A Comment', 398.

the operational risk, to establish the own funds requirements of the credit institutions (Article 92(3)(e) of the CRR) and in the context of the periodic supervisory review and evaluation process (SREP) (Article 97 of the CRDIV).[307] In this regard, the EBA specified that the conduct risk (i.e. 'the current or prospective risk of losses to an institution arising from inappropriate supply of financial services including cases of wilful or negligent misconduct'[308]) should be assessed taking into account the exposure of the supervised entity, *inter alia*, to mis-selling of products, in both retail and wholesale markets, including pushed cross-selling of products to retail customers and conflicts of interest in conducting business.[309]

In conclusion, conduct risk is only one of the relevant risks to be assessed to ensure the safety and soundness of financial firms. The prudential requirements imposed to mitigate conduct risk can certainly serve as deterrent against misconduct and thus indirectly contribute to increasing the protection of consumers.

5. The national models

Although the ESMA has never used its powers to formally 'direct' the actions of the NCAs, it is argued that its quasi rule-making and quasi-supervisory powers have an impact on the supervisory activity of the NCAs, and ultimately, on financial market participants. To demonstrate this hypothesis, the next sections examine (i) the institutional framework (objective, tasks and powers) and (ii) the supervisory approach (*ex ante*/*ex post*, on-site/off-site, restrictive/non-restrictive, formalistic/informal)[310] of the Italian, French, Spanish and the British NCAs.

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[307] See E. Ferran. 'European Banking Union: Imperfect, But It Can Work', *PAPER NO. 30/2014 APRIL 2014*, p. 7.
[308] EBA. Guidelines on Common Procedures and Methodologies for the Supervisory Review and Evaluation Process' EBA/GL/2014/13 (2014), para 253.

[309] EBA, Guidelines on Common Procedures and Methodologies for the Supervisory Review and Evaluation Process'para 254.
[310] ESMA. MiFID – Conduct of Business, fair, clear and not misleading information, p. 5.

5.1. Italy

5.1.1. Institutional framework

The Commissione Nazionale per le Società e la Borsa ('CONSOB') is responsible for 'transparency and fairness of conducts' of financial services providers, whereas Banca d'Italia is primarily responsible for the micro- and macro-prudential supervision of all financial market participants and for the conduct supervision of banking services providers.[311] The supervision on the insurance undertakings is carried out by the Istituto per la Vigilanza sulle Assicurazioni ("IVASS"). The three authorities have a statutory duty to cooperate and exchange information[312] and have signed several MoUs, between 2007 and 2012, to enhance cooperation and information exchange on their supervised entities. Therefore, the Italian supervisory model is a variant of the 'pure' twin-peaks model because the Banca d'Italia, which is the sole prudential supervisor, has also a consumer protection mandate and IVASS is responsible for the supervision of insurance undertakings.

To carry out its investor protection objective, the CONSOB has fully-fledged regulatory, supervisory and enforcement powers. The CONSOB can require the cessation of any practice that is contrary to the regulatory provisions and can restrict or limit the business, operations or any service where the breach could prejudice general interests and where there is an urgent need to protect investors.[313]

5.1.2. Supervisory approach

Since 2009 the CONSOB has taken several actions to enhance the protection of retail clients with particular regard to complex financial products. In the 2009 the CONSOB recommended investment firms identify the target for their financial protects taking

[311] See Article 5(3) of the Legislative Decree No 58/1998 (TUF) and Article 127(01) of the Legislative Decree No 385/1993 (TUB).
[312] Article 7(5) of the TUB.
[313] Article 51 of the TUF.

into account the risks related to the financial engineering and complex financial products as well as specific duties of information with regard to the costs components (e.g. fair value and price) of financial instruments.[314] In 2014 the CONSOB issued another communication, which implemented the ESMA opinions on the MiFID practices for firms selling complex products and on Structured Retail Products and the ESMA statement on COCOs requiring firms to communicate to the CONSOB their compliance and, in case of non-compliance, to inform clients that the product was deemed to be unsuitable by the CONSOB.[315] In 2015, after the transposition of the BRRD into Italian law, the CONSOB recommended financial firms to provide adequate information to clients regarding the regulatory innovations of that Directive, in particular the bail-in, and to revise their internal organizational process in order to update the appropriateness and suitability tests to the new BRRD's rules.[316] This communication is in line with ESMA's concern that the new legal framework for resolution and the MREL/TLAC requirements, which impose on credit and ivnestment firms to issue eligible liabilities, could entail risks for investors, stemming from the lackof transparency and difficulties in assessing the risk profile of the debt instruments.[317] In 2016, following the the ESMA Guidelines on complex debt instruments and structured deposits and cross-selling practices, the CONSOB launched a public consultation on recommendations about disclosure requirements for the distribution of financial products to clients.[318] This public consultation notably

[314] CONSOB. Comunicazione n. 9019104 del 2 Marzo 2009 sul dovere di correttezza e trasparenza dell'intermediario in sede di distribuzione di prodotti finanziari illiquidi. Available on http://www.consob.it/documents/46180/46181/c9019104.pdf/64f86e70-2bb0-460a-8f60-3dd079b6341d

[315] CONSOB. Comunicazione n. 0097996 del 22 dicembre 2014 sulla distribuzione di prodotti finanziari complessi ai clienti *retail. Available on http://www.consob.it/main/documenti/bollettino2014/c0097996.htm*

[316] CONSOB. Comunicazione n. 0090430 del 24 November 2015. Decreti legislativi nn. 180 e 181 del 16 novembre 2015 di recepimento della direttiva 2014/59/UE. Prestazione dei servizi e delle attività di investimento, nonché dei servizi accessori. Availble on http://www.consob.it/documents/46180/46181/c0090430.pdf/09b990c7-1e84-486c-bc24-9875e68e63cd

[317] ESMA. Report on Trends, Risks and Vulnerabilities No. 1, 2016, p. 41.

[318] CONSOB. Documento di consultazione. Principi guida sulle informazioni chiave da fornire ai clienti al dettaglio nella distribuzione di prodotti finanziari. 9 maggio 2016. Available on: http://www.consob.it/documents/46180/46181/cons_20160509_inf_chiave.pdf/71c2a00a-4303-474e-bda8-f870a7eed943

reflected the CONSOB's behavioural approach to conducting supervision,[319] based on an acknowledgement of the poor limited financial literacy of Italian retail clients and their excessive reliance on execution-only services in distribution.[320]

In conclusion, the CONSOB's supervisory approach shows a high level of adherence to the ESMA's acts[321] and supervisory priorities,[322] with particular regard to the governance (production) and distribution of complex financial products.

5.2. Spain

5.2.1. Institutional framework

The Comisión Nacional del Mercado de Valores ('CNMV') was established in 1988 to ensure the transparency of financial markets, the correct formation of prices and the protection of investors.[323] The Banco de España is responsible for the micro and macro-prudential supervision of financial market participants and conduct supervision on banking service providers. The Dirección General de Seguros y Fondos de Pensiones ('DGSFP') is responsible for the supervision of insurance undertakings. The Spanish supervisory model, therefore, is based a sectoral model, even if the Banco de España's prudential mandate covers all financial market participants.

A distinctive feature of the Spanish system is that the Ministry of Finance retains significant residual regulatory and supervisory powers (i.e. granting of authorizations to carry out banking activity).[324] The CNMV has the regulatory power to adopt circulars where expressly permitted to do so by the relevant Royal Decree or MEC

[319] M. Gentile, N. Linciano, P. Soccorso. Financial disclosure, risk perception and investment choices Evidence from a consumer testing exercise, CONSOB Quaderni di Finanza, No. 82, May 2015.

[320] M. Gentile, N. Linciano, P. Soccorso, Financial advice seeking, financial knowledge and overconfidence. Evidence from the Italian market. CONSOB Quaderni di Finanza, No. 83, March 2016.

[321] Until 10 January 2016, CONSOB communicated to ESMA its intention to comply with all the guidelines.

[322] See CONSOB. Annual Report 2015. 2016, p. 9 and IMF. Country Report No. 13/353. December 2013, p. 124.

[323] Article 13 and 14 of the LMV.

[324] IMF. Country Report No. 12/143. June 2012 IMF, p. 5.

order,[325] and a wide range of supervisory powers including the power to require a person to cease a practice that does not comply with the legislation, to seek court orders freezing assets and to place a temporary ban on professional activity.[326]

5.2.2. Supervisory approach

After the financial crisis, the CNMV's investor protection mandate was driven by the need to prevent mis-selling of hybrid financial products, especially *participationes preferentes* (PPRs). The PPRs are perpetual and variable income financial instruments with no voting rights nor shareholding, which rank after subordinate debt in the case of issuer's insolvency.[327] Over the last ten years PPRs have been one of the most important funding channels for commercial and saving banks: between 1998 and 2012, the nominal amount of PPRs' issuance reached EUR 115 billion (1.2% of GDP), representing 96% of the retail financial market.[328] However, after the end of 2008 financial firms no longer granted PPR holders the early redemption of notes. This has led to declines in the potential value of early redemptions of PPRs and has triggered claims of mis-selling of these instruments.

From 2007 the CNMV became aware about the risks involved in the distribution of PPRs,[329] but it issued a guide implementing the CESR Q&A, to inform markets about their risks only in 2010.[330] The CNMV's supervisory action intensified after the legislative reforms introduced in 2012 and a Memorandum of Understanding (MoU)

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[325] Article 15 of the LMV.
[326] Article 85 of the LMV.
[327] The CESR determined that they are not complex financial products per se (See CESR, MiFID Complex and Non-Complex Financial Instruments for the Purposes of the Directive's appropriateness requirements, 2009 (9–558)). See, in more detail, F. Zunzunegui, Mis-selling of preferred shares to Spanish retail clients' 29 Journal of International Banking Law and Regulation (2014): 174.
[328] Comisión de seguimiento de instrumentos híbridos de capital y deuda subordinada 17 de mayo de 2013: *Informe sobre la comercialización de instrumentos híbridos de capital y deuda subordinada (real decreto-ley 6/2013, de 22 de marzo),* p. 12.
[329] See F. Zunzunegui. 'Mis-selling of preferred shares to Spanish retail clients' 174.
[330] CNMV. Guia sobre catalogacion de los instrumentos financieros como complejos o no complejos.14 de octubre de 2010. Available on http://www.cnmv.es/docportal/guias_perfil/guiainstrumcomplejosnocomplejos.pdf

signed on 20 July 2012 between the Kindgom of Spain and the European Commission to grant Spain financial support from the European Financial Stability Facility (EFSF) and, subsequently, the European Stability Mechanism (ESM). Under the oversight of the European Commission, the ESM and the International Monetary Fund, Spain adopted important reforms to strengthen Banking prudential requirements and supervision,[331] regulate mortgages loans and real estate assets of the financial institutions,[332] and enhance transparency of the financial market.[333] In particular, law No 9/2012 introduced important measures aimed at reducing the impact of the detrimental businesses conducts related to the selling of complex financial products, including stricter requirements for Banks to issue partecipationes preferentes,[334] imposed new conduct of business rules on financial firms[335] and conferred new powers to the CNMV in order to monitor the selling of complex financial products (new Article 79bis(3) of the LMV).

In 2012 the total amount of fines imposed by the CNMV to raised up to EUR 24.4 million.[336] In 2014 the CNMV issued a circular[337] and guide to strengthen product governance requirements, thus anticipating the substance of the ESMA opinion on

[331] Royal Decree-Law 2/2012, of 3 February, on restructuring the financial sector.
[332] Royal Decree-Law 6/2012, of 9 March, on urgent measures to protect mortgagors with limited resources. See also Law 8/2012, of 30 October, on the reorganisation and sale of real estate assets in the financial sector.
the Royal Decree-Law 18/2012, of 11 May, on the restructuring and sale of real estate assets of the financial sector that establishes additional coverage requirements for the impairment of loans linked to real estate activity classified as 'in a normal situation'.
[333] See, for the most important measures thereby established, CNMV, Annual report for 2012, p. 291.
[334] See the 13th additional provision of the Law establishes certain requirements for marketing preferred shares, convertible debt instruments and subordi- nated financing calculated as equity to retail investors.
[335] See the new Article 79 bis (6 and 7) of the LMV. On this provision see the circular of the CNMV. Circular 3/2013, 12.6.2013, sobre el desarrollo de determinadas obligaciones de información a los clientes a los que se les prestan servicios de inversión, en relación con la evaluación de la conveniencia e idoneidad de los instrumentos financieros. See, for a comment, E. R. Achútegui. 'Preferentes: un catálogo de debates', Revista Aranzadi Doctrinal, num.1/2013.
[336] Between 2004 and 2010 the total amount of fines imposed on financial intermediaries was between EUR 1.6 (2005) and 18.6 million (2007). See CNMV, Annual reports from 2005 to 2012.
[337] CNMV. Circular 1/2014, de 26 de febrero sobre los requisitos de organización interna y de las funciones de control de las entidades que prestan servicios de inversión. Available on https://www.boe.es/buscar/doc.php?id=BOE-A-2014-3559.

product governance.[338] As regards product intervention, the CNMV adopted a circular to require financial firms, in accordance with Article 79bis(3) of the LMV, to include pre-contractual information stating that the CNMV considers that the product is not adequate due to its complexity or its acquisition by non-professional clients. If the client decides to buy the product, notwithstanding this warning, the client must include a signature below that warning and personally the statement 'the product is difficult to understand'.[339]

In 2015 the Ministry of Economy and Competitiviness issued an Order requiring financial firms to assess the risk of the financial products (i.e. deposits, bonds, shares or units in pension funds) on a six-colour scale.[340] This 'traffic-light system', already proposed by the CNMV,[341] is mandatory but leaves the clients free to choose whether to buy the financial product. The CNMV's supervisory attention for the distribution as well as design/governance of financial products emerges also from two thematic reviews on retail financial products, respectively on conduct requirements[342] and contracts for difference (CFD) on complex financial products.[343] The ESMA reported that the CNMV receives quarterly reports from all investment firms identifying all new products sold in the previous quarter and whether such products were complex or

[338] CNMV. Guia de procedimentos de las functiones de control interno a que se refiere la circular 1/2014. Available on https://www.cnmv.es/DocPortal/GUIAS_Perfil/GuiaControlInterno.pdf

[339] See also ESMA Stakeholder Group. 'Advice to ESMA. Investor Protection Aspects of the Consultation Paper on MiFID II and MiFIR', p. 27 which underscored that the 'toxicity' of the product (the high probability of not achieving stated/advertised goals and/or of destroying the real value of savings) should be a criterion to take restrictive measures on financial products.

[340] Ministerio de Economía y Competitividad. Orden ECC/2316/2015, de 4 de noviembre, relativa a las obligaciones de información y clasificación de productos financieros. BOE-A-2015-11932.

[341] CNMV. Proyecto de circular sobre advertencias relativas a instrumentos financieros, Enero 2015. See also CNMV. Consulta de la CNMV relativa a un sistema de clasificación de instrumentos financieros e identificación de productos especialmente complejos, Septiembre 2014. Since trade organisations complained that CNMV lacked powers to adopt the proposed warning, the CNMV decided before approving the proposal to submit the Draft Circular to the Council of State (through the Ministry of Economic Affairs and Competition), requesting its mandatory report. For more details, see CNMV, Annual report 2012, p. 177.

[342] See CNMV, CNMV Circular 3/2013, of 12 June, on information obligations with regard to appropriateness and suitability the distribution practices

[343] CNMV. Annual report 2014, p. 172 (finding that 75% of people investing in CFDs between 1 January 2012 and 31 October 2013 lost money).

non-complex and sold on an advisory or non-advisory basis.[344]

To conclude, after the global financial crisis, the CNMV intensified its risk-based approach to product regulation and implemented a new legislative measure adopted to address the large scale mis-selling of complex financial products. The CNMV has also anticipated, much more than CONSOB and AMF, some of the MIFID II regulatory changes and ESMA product regulation approaches. This difference can be explained by the critical impact of product mis-selling on the stability of the Spanish financial system as well as the real economy.

5.3. France

5.3.1. Institutional framework

The Autorité des marchés financiers ('AMF'), established in 2003, is responsible for the protection of investors and efficient functioning of financial markets.[345] The AMF should take into account the need to ensure the stability of the Union and the implementation of national and EU regulations, good practices and recommendations adopted by EU authorities.[346] Since 2010, the Autorité de contrôle prudentiel ("ACP"), now Autorité de contrôle prudentiel et de résolution ("ACPR"),[347] is responsible for the micro-prudential supervision and the protection of clients of credit and insurance firms.[348] An institutional cooperation mechanism (the *Pôle Commun*) was created by law in 2010 to facilitate coordination between the Authorities.[349] Finally, the Conseil de la régulation financière et du risque systémique ("COREFRIS") was established in 2010 with the aim of identifying and address possible systemic risks. These reforms

[344] ESMA. MiFID Suitability Requirements Peer Review Report. 7 April 2016. ESMA 2016/584, 9.
[345] The loi n° 2003-706 du 1 Août 2003 de sécurité financière conferred on the AMF the supervisory and regulatory powers previously held by the Conseil des marchés financiers (CMF), the Commission des opérations de bourse (COB) and the Conseil de discipline de la gestion financière (CDGF).
[346] Article L 621-1 of the Code Monetaire et Financiere (CMF).
[347] Loi n° 2013-672 du 26 juillet 2013 de séparation et de régulation des activités bancaires.
[348] Article 612-1.-I. of the CMF as amended by the Ordonnance n° 2010-76.
[349] Article L. 612-47 of the CMF.

show the effort to shift from a traditional sectoral supervisory model towards a twin-peaks supervisory model.[350] However, like the Italian model, the French model is variation of the pure twin-peaks model because the ACPR remains responsible for the protection of clients of credit and insurance firms.[351]

The AMF has regulatory, supervisory and enforcement powers. The AMF general regulation (*règlement general*), adopted in 2004, lays down the conduct of business rules transposing the MiFID I and the product governance obligations for market participants. Further, the AMF elaborates these rules through instructions, positions and non-binding recommendations ('*doctrine*'). Besides a wide range of intervention powers regarding securities trading and issuances,[352] the AMF, unlike the CONSOB, can, on a request of one or more financial service providers or a trade association and after hearing from the Banque de France, certify (*certifier)* contracts on financial instruments.[353] To this end, the AMF shall assess the conformity of contract terms with the provisions of the AMF General Regulation.

5.3.2. Supervisory approach

After the financial crisis, the AMF shifted the focus of its activity to advertising and marketing practices in the distribution of complex financial instruments. As reported by the ESMA, the AMF set up a pre/approval process for marketing documentation attached to more risky/complex investment funds.[354] In 2010 the AMF issued a *position* regarding the marketing of complex financial instruments through public offerings and not 90% capital guaranteed to retail clients. This measure requires financial service provider to submit to the AMF the marketing documentation for these products for pre-approval and requires prospectus to include a specific warning on the

[350] See B. Deletre, J. Azoulay, P. Dugos. Rapport de la Mission de Conseil sur le Controle du Respect des Obligations Professionnelles a l'egard de la clientele dans le secteur financier.Inspection générale des finances N° 2009-M-040-03, p. 10.
[351] See IMF, France: Country Report No. 13/182. June 2013, p. 6.
[352] See Article L621-8-2.
[353] See Article L621-18-1 and Article 131-1 of the AMF General Regulation.
[354] ESMA. MiFID – Conduct of Business, fair, clear and not misleading information, 22.

complexity of the financial instrument for retail clients.[355] Although this measure is not in itself legally binding, non-compliance can trigger supervisory actions.[356] In 2013 the AMF issued a recommendation to indicate, in accordance with Article L533–12 of the CMF, correct practices for the compilation of contractual documentation related to structured debt instruments.[357] After a comprehensive review of the online foreign exchange (forex or FX) market, the AMF warned that approximately 89% of clients had, over a four year investment period, lost money in CFDs, binary options and other complex financial products.[358] The AMF has also anticipated the position expressed by the ESAs some years later in connection to self-placement practices,[359] and treatment of internal complaints. [360]

This supervisory actions of the AMF have been recently underpinned by the law 1691/2016 (Sapin II) which introduced important regulatory innovations for the protection of consumers and investors.[361] This law introduced the consumer code a general and outright prohibition to address, directly or indirectly, electronic advertising to clients who are not professional clients[362] and amended the code monetaire et financiare as to prohibit financial firms from addressing, directly or indirectly, electronic communications addressed to potential clients who are not

[355] AMF. Position n° 2010-05 sur la commercialisation des instruments financiers complexes. Available on http://www.amf-france.org/Reglementation/Doctrine/Doctrine-list/Doctrine.html?docId=workspace%3A%2F%2Financial_firmacesStore%2F8f1c7f9a-90bc-4afa-94cf-4b5db749a747&category=IV+-+Commercialisation+-+Relation+client

[356] See ESMA Stakeholder Group. Own initiative report on product intervention under MiFIR, p. 17

[357] AMF. Position - recommandation AMF n° 2013-13 – Guide pour la rédaction des documents commerciaux dans le cadre de la commercialisation des titres de créance structurés. Available on http://www.amf-france.org/Reglementation/Doctrine/Doctrine-list/Doctrine?docId=workspace%3A%2F%2Financial_firmacesStore%2F7655ac7b-4730-418f-8544-233727437709&category=IV+-+Commercialisation+-+Relation+client

[358] See AMF. Annual report 2013, p. 20 and AMF. Study of investment performance of individuals trading in CFDs and forex in France. 13 October 2014.

[359] AMF. Placement et commercialisation d'instruments financiers – DOC-2012-08. Available on http://www.amf-france.org/Reglementation/Doctrine/Doctrine-list/Doctrine?docId=workspace%3A%2F%2Financial_firmacesStore%2Ff8f0fcf0-0fc4-43f3-8030-984291031bd9&category=III+-+Prestataires

[360] See ESAs. Placement of financial instruments with depositors, retail investors and policy holders ('Self placement'). JC 2014 62. 31 July 2014 and ESMA-EBA, Guidelines for complaints-handling for the securities (ESMA) and banking (EBA) sectors. JC 2014 43. 13 June 2014.

[361] Loi n° 2016-1691 du 9 décembre 2016 relative à la transparence, à la lutte contre la corruption et à la modernisation de la vie économique. JORF n°0287 du 10 décembre 2016.

[362] Article 222-16-1 of the Code of consommation.

professionals regarding financial instruments identified by the AMF.[363] According to the Law 1691/2016, these instruments shall have one of three following characteristics: the risk which is not known when the contract is concluded, risk of loss is higher than the initial capital subscribed, the risk of loss, in comparison to the possible returns, is not 'reasonably comprehensible' taking into account the specific nature of the contract .

On the basis of the law 'Sapin II', on 27 February 2017, the AMF issued a prohibition of electronic publicity related to highly speculative and risky financial contracts addressed to retail clients.[364] Although the ban was meant to target binary bets, CFDs and foreign exchange products, the AMF, given the resistance expressed by the industry for a 'name-and-shame' effect for such products,[365] decided to replace the specific reference to these products with a generic reference to categories of contracts with certain characteristics.

To conclude, althouguh the AMF has adopted an intrusive approach, mostly conveyed through soft-law measures (*positions* and *recommendations*), in the regulation of financial products, through off-site (e.g. electronic monitoring of campaigns linked to retail investment products) and on-site activities. In practice, as the IMF reported, this approach could, restrict the marketing of of highly complex structured products.[366] Like the CONSOB and the CNMV, the AMF has adhered to the CESR[367] and ESMA standards, in particular, for the implementation of the MiFID conduct business rules.[368]

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[363] Article 533-12-7 of the CMF.

[364] Règlement général de l'AMF (le « RGAMF »), Order of 27 February 2017, Official Journal of 7 March 2017. See for more details ESMA Stakeholder Group. Own initiative report on product intervention under MiFIR, p. 18.

[365] AMF, Bilan de la consultation publique de l'AMF clôturée le 30 septembre 2016 relative à l'interdiction de la publicité portant sur certains contrats financiers hautement spéculatifs et risqués. 10 Janvier 2017. Available on http://www.amf-france.org/Actualites/Communiques-de-presse/AMF/annee-2017.html?docId=workspace%3A%2F%2Financial firmacesStore%2Ff12bcdf3-0a29-4cde-912f-616b0f8f45c8

[366] See IMF, France: Country Report No. 13/182. June 2013, p. 124-130. See also See Y. Svetiev, A. Ottow. 'Financial Supervision in the Interstices Between Private and Public Law', p. 524.

[367] AMF. Recommandation DOC-2014-07: Guide relatif à la meilleure exécution implementing the CESR, Best Execution under MiFID, Q&A. CESR/07-320. Available on http://www.amf-france.org/Reglementation/Doctrine/Doctrine-list/Doctrine?docId=workspace%3A%2F%2Financial firmacesStore%2Fcd899cc7-0a78-4172-8355-46ff1af28277&category=III+-+Prestataires

[368] See, in particular AMF. Exigences relatives à l'adéquation pour un client de services d'investissement ou d'instruments financiers – DOC-2012-13, implementing the ESMA, Guideline on certain aspects of the

5.4. The UK

5.4.1. Institutional framework

In 2000 the Financial Service and Market Act ("FSMA") set up the Financial Service Authority ("FSA") to replace the previous regulatory/supervisory system based on self regulatory organizations ("SROs") and the Securities and Investments Board.[369] The FSA was made responsible for the prudential and conduct supervision of banking, financial and insurance firms. At the same time, the Bank of England retained responsibility for the overall stability of the financial system and the Treasury for the institutional structure of the financial regulatory system.

After the global financial crisis, the UK shifted from a sectoral tripartite system to a twin-peaks supervisory model.[370] The Financial Services Act 2012 replaced the FSA with the Financial Conduct Authority ("FCA"), tasked with the conduct supervision, and the Prudential Regulatory Authority ("PRA"), which is now part of the Bank of England, tasked with the micro-prudential supervision of banking, financial and insurance firms.[371] In addition, the Financial Policy Committee ("FPC"), created within

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MiFID suitability requirements. See for the overview of the ESMA guidelines implemented by the AMF: Orientations ESMA appliquées par l'AMF. Available on http://www.amf-france.org/Reglementation/Textes-europeens/Orientations-ESMA.html

[369] The SIB was a private company funded by the industry and entrusted with statutory and enforcement powers. The SIB authorized financial firms through a number of SROs, which were recognized as SIB's members and were entrusted with the conduct regulation of their members. The original members were the Association of Futures Brokers and Dealers (AFBD); the Financial Intermediaries, Managers and Brokers Regulatory Association (FIMBRA); the Investment Management Regulatory Organisation (IMRO); and the Securities Association (TSA). For more detail on the SIB and SROs, see E. Lomnika. 'Private Damages Claims for Breaches of Securities Regulation Law' in R. Plender (ed.). *Legal History and Comparative Law. Essays in Honour of Albert Kiralfi*, London: Frank Cass., 1990, p. 133 and L. C. B. Gower. '"Big Bang" and City Regulation' 51 Modern Law Review (1988): 11

[370] See A. Hudson. The Law of Financial Derivatives. London: Sweet and Maxwell, 2013, p. 894 who noted that this change was mostly driven by the political willingness to replace the FSA which has been identified so closely with the previous Labour Governement. See also S. Sassoon, The Tripartite Review: A review of the UK's tripartite system of financial regulation in relation to financial stability. Preliminary Report. March 2009). Available at: <http:// www.conservatives.com/News/News_stories/2009/03/Osborne_welcomes_Sassoon_report_into_tripartite_financial_regulation.aspx;

[371] The Financial Service Act 2010 conferred on the FSA the financial stability objective and new powers, including a ban on short selling and required it to establish a 'consumer financial education body'. Since the 1 March 2017, in accordance with the Bank of England and Financial Services Act 2016, the PRA Board

the Bank of England, is responsible for the macro-prudential supervision and has the power to issue legally binding directions to the FCA and the PRA.[372] The Authorities shall consult each other before exercizing their qualifying functions as defined by the FSMA and the Memorandum of Understaindg. However, the PRA has the power to give 'directions' to the FCA in particular when it is necessary to protect the stability of the UK financial system and the FCA shall comply with the direction unless compliance would be incompatible with any EU or international obligation.[373]

Under this new institutional framework, the overriding objective of the FCA (like the FSA) is 'ensuring that the relevant markets' (see section 1F) function well. Consumer protection is one of its operational objectives, together with the integrity and competition objectives. In particular, the FSMA specifies that the consumer protection objective should be pursued taking into account the 'general principle that consumers should take responsibility for their decisions' and the that 'those providing regulated financial services should be expected to provide consumers with a level of care that is appropriate having regard to the degree of risk involved in relation to the investment or other transaction and the capabilities of the consumers in question.' The Financial Services Act 2012 also introduced some changes in the private enforcement of conduct and prudential rules,[374] updated the consumer redress scheme (introduced by the FSMA), strengthened the cooperation and exchange of information between the FCA and Financial Ombudsman Service ("FOS") and, following the initiatives taken by the FSA in 2011,[375] introduced new product intervention rules.[376]

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was replaced by the Prudential Regulation Committee (PRC) and the PRA became part of the single legal entity of the Bank of England.

[372] Sections 9B and 9H of the Bank of England Act 1998, as amended by the Financial Services Act 2012.

[373] Section 3H of the FSMA.

[374] Whereas the firm's failure to comply with the FCA's handbook gives rise to a statutory liability, unless otherwise established by the authority (section 138D (2, 3), the breach of the PRA's handbook gives rise to statutory liability only if the PRA states so (Section 138D (2)). Schedule 5 of each sourcebook of FCA Handbook lists the non-actionable rules of the sourcebook. See also *R (on the application of the British Bankers Association) v The Financial Services Authority, The Financial Ombudsman Service and Nemo Personal Finance Ltd* [2001] EWHC 999 (Admin).

[375] See FSA. Discussion Paper on Product Intervention. DP11/1. January 2011.

[376] See HM Treasury. A new approach to financial regulation: the blueprint for reform. June 2011, p. 60.

Finally, it must be borne in mind that the FCA, unlike the CONSOB, the AMF and the CNMV, has also consumer protection-related powers. The FCA is a 'qualifying body' under the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCR) and a 'regulator' under the Consumer Rights Act 2015 (CRA),[377] and in this capacity can apply for an injunction against firms using unfair contract terms in financial and in certain banking contracts,[378] before the Director-General of Fair Trading or national courts[379] and accept undertakings that the firm will comply with the conditions that are agreed between the FCA and that firm.[380] The firm should consider the impact of a court's declaration of unfairness or the firm's undertaking on its own business and should take actions to reduce potential risks (i.e. related to the internal product governance processes). The FCA may also undertake a review of contract terms of its own motion if it considers that, in aprticular because of the high number of consumer complaints, the provisions of the CRA are not respected.[381]

5.4.2. Supervisory approach

A) The Treating Customers Fairly ("TCF") initiative

Since its establishment, the FSA has shown its intention to address the problems of large scale mis-selling by combining traditional enforcement and sanctioning tools and innovative supervisory tools (e.g. thematic reviews, firm's self-committments) which reflect a principle-based and outcome-based approach to conduct supervision. This supervisory approach has particularly emerged in the ongoing Treating Customers Fairly ("TCF") initiative, which was announced by the FSA in 2001 to achieve the

[377] The FSA and FCA issued Unfair Contract Terms Regulatory Guide (UNFCOG), which is part of the Handbook, to implement the UTCCR and the CRA.
[378] The FSA became a qualifying body on 1 May 2001 and agreed with the Office of Fair Trading (OFT) to take responsibility for the review of contract terms falling outside the FSMA regulated activities, such as mortages. See, in more detail, FSA, The FSA's approach to the use of its powers under the Unfair Terms in Consumer Contracts Regulations 1999 CP 148. July 2002.
[379] Article 12 of the UTCCR and Article 3 of the CRA. If the use of an unfair term also amounts to a *rule* breach, and that breach causes loss to *consumers*, the *FCA* can apply to court for restitution or require restitution (UNFCOG 1.6.1).
[380] Article 14 of the UTCCR and Article 6 of the CRA.
[381] UNFCOG 1.4.3.

statutory consumer protection objective through a comprhensive review of the firm's internal management, processes, and performance.[382] The TCF covers all the firms involved in the retail supply chain and aims at achieving six 'consumer outcomes',[383] whose achievement is monitored at all points in the product's design-distribution chain through data reporting to the FSA. Hence, whilst the TCF was not based on formal rules or supervisory decisions, it involved intense conduct supervision to ensure that the firms pursue the TCF's consumer outcomes.[384]

However, the FSA's reliance on the capability of firms to conduct thematic reviews, report reliable data and remedy their internal processes deficiencies have proved to be the main challenges of the TCF.[385] Not only the lack of prescriptive rules increased the uncertainty regarding legal risks but also the presumption that self-collected data, elaborated by the firms' internal softwares, reflect the reality could be questioned.[386] In addition, as J. Black noted, the TCF shown that the FSA and the firms interpreted the consumer outcomes in different ways: for example, firms considered the customers' satisfation as a evidence that products were suitable, the FSA argued that customers cannot assess suitability themselves and that the might be satisfied even if sold an unsuitable product.[387]

B) The review of interest rate hedging products (IRHPs)

After the global financial crisis, the FSA and the Treasury acknowledged the need to adopt 'a more proactive, interventionist approach […] so that actual or potential risk is

[382] See FSA. `Treating Customers Fairly after the point of sale', FSA Discussion Paper 7 (2001). The FSA has monitored the progress and achievements of the TCF through several papers including: Treating customers fairly – progress and next steps, July 2004; FSA. Treating customers fairly – towards fair outcomes for consumers, July 2006; FSA, Treating Customers Fairly: progress report (May 2007); and FSA, Treating Customers Fairly – Culture (July 2007).
[383] FSA. Treating customers fairly – towards fair outcomes for consumers. July 2006, p. 3.
[384] See J. Black. 'The Rise, Fall and Fate of Principles Based Regulation', LSE Law, Society and Economy Working Papers 17/2010, p. 17.
[385] See J. Patient, `Treating Customers Fairly: the challenge of principles-based regulation' 22 Journal of International Banking Law and Regulation (2007): 420; J. Black, M. Hopper, and C. Band. 'Making a Success of. Principles Based Regulation' 3 Law and Financial Markets Review (2007): 191.
[386] See A. Georgosouli. 'The FSA's `Treating Customers Fairly' (TCF) Initiative: What is So Good About It and Why It May Not Work' 38 Journal of Law and Society (2011): 424.
[387] See J. Black. 'The Rise, Fall and Fate of Principles Based Regulation', p. 18.

acted upon before it crystallises in significant detriment.'[388] In line with this new supervisory approach, the FSA in 2012 conduced a review on structured financial products' that highlighted the inadequate internal product's approval processes used across firms and the lack of firm's focus on consumers' needs and wants in the product's design phases.[389]

Another major initiative undertook by the FSA in 2012 is the review interest rate hedging products (IRHPs).[390] The FSA found evidence of poor practices in the firm's sale of IRHPs to retail clients. Following this review, the nine banks involved agreed to review their sales of IRHPs made to unsophisticated retail clients since 2001.[391] The banks appointed an independent reviewers to review all sales of IRHPs and to provide redress to clients on the basis of what is fair and reasonable in the circumstances to 'non-sophisticated' customers. According to the FSA 'fair and reasonable' redress means 'putting the customer back in the position they would have been in had the regulatory failings not occurred.'[392] This redress should include compensation for the actual and any consequential loss (e.g. loss of profit) according to the legal principles relating to claims in tort and breach of statutory duty.[393] The banks have sent 18,200 redress determinations to customers, 14,700 of which include a cash redress offer, and 3,500 confirm that the IRHP sale complied with the rules or that the customer suffered no loss. To date, around 95% of offers have been accepted.

C) Product bans

[388] HM Treasury. A new approach to financial regulation: the blueprint for reform. 2011, p. 70. See also FSA, Journey to the FCA. October 2012, p. 12.
[389] FSA. 'Retail Product Development and Governance – Structured Product Review'. March 2012.
[390] An IRHP is means a derivative which is separate to a lending arrangement and is for the purpose of managing interest rate fluctuations (i.e. structured collars, swaps, simple collars and cap products).
[391] For the details on the procedure see CFA Institute, Redress in Retail Investment Markets. International Perspectives and Best Practices, 2014, 52.
[392] See https://www.fca.org.uk/consumers/interest-rate-hedging-products/redress
[393] The banks have agreed to adopt the Financial Ombudsman Service's approach to compensate opportunity costs, which is to add 8% simple interest per year to all basic redress offers. Customers who believe their 'lost opportunity' costs were more than 8% per year can make a consequential loss claim for loss of profits (see See https://www.fca.org.uk/consumers/interest-rate-hedging-products/redress).

The FCA can adopt temporary restrictions of financial products to achieve the consumer protection objective or the efficiency and choice objective, or, if the Treasury by order provide for this paragraph to apply, the integrity objective (section 137D (1)(2) of FSMA 2000). Before adopting the measure the FCA shall consult the PRA and publish a draft of the proposed rules and the documentation required by s. 138 I, unless compliance with these requirements could prejudicate the consumer protection objective or the competition objective or the integrity objective (s. 138M 1).[394] Importantly, in the event of the contravention of the product intervention rules, the FCA may provide that the agreement is unenforceable against any person, the recovery of any money or other property paid or transferred under a relevant agreement and/or the compensation for any loss sustained by any person or specified person as a result of paying or transferring any money or other property under a relevant agreement or obligation (unenforceability and compensation provisions) (s. 137D(7)).

The FCA, following a public consultation,[395] published a statement of policy ("SoP") that lists the criteria and factors that shall be taken into account before adopting the restrictive measures.[396] Unlike the ESMA, the FCA places more emphasis on 'consumer detriment' (i.e. the 'loss [suffered by investors] due to breaches of our rules or the wider duty to act fairly and reasonably'),[397] which is the general driving factor to be considered before adopting a product intervention measure.[398] The SoP also clarifies the importance issue of the relationship between product intervention measures and contract law. In particular, the 'unenforceability provision' mentioned above applies only to sales made after the introduction of the rules and in contravention of those rules. In this case, investors should only demonstrate that the financial contract was the subject of a product intervention rule (whether temporary or not) and that they entered into it after the relevant product intervention rule came into effect.[399] By

[394] Special consultation requirements apply if the product intervention rule is adopted to mutual societies (s. 138K).
[395] FCA. 'The FCA's use of temporary product intervention rules'Consultation Paper (CP) 12/35. December 2012.
[396] FCA. 'The FCA's use of temporary product intervention rules'. March 2013.
[397] FSA. 'Product intervention'.January 2011, p. 5.
[398] FSA, The FCA's use of temporary product intervention rules, PS13/3. March 2013, p. 20.
[399] FSA, The FCA's use of temporary product intervention rules, p. 31.

contrast, if the contract was concluded *before* the introduction of the product intervention rules, the usual burden of proof should apply; hence, investors would need to demonstrate that they suffered a loss because of unsuitable advice or breach of other conduct of business rules.[400]

On the basis of this SoP, the FCA has already adopted some product intervention rules.[401] In 2014 the FCA adopted rules to restrict the distribution of CoCos to retail clients from 1 October 2014 until 1 October 2015.[402] In motivating the restrictive measure, the FCA observes that 'the increasing issuance of CoCos to meet prudential capital requirements might lead to the marketing of these instruments to ordinary retail investors, who would not be able to assess the risks entailed adequately.' Later, the FCA adopted permanent rules to prohibit the distribution of CoCos and common equity tier 1 (CET1) share instruments issued by mutual societies to retail clients.[403] The FCA has also made general rules restricting the distribution of unregulated collective investment schemes UCIS to retail clients.[404]

D) Consumer redress scheme ("CRD")

The FCA has the power to require firms to set up a consumer redress scheme ("CRD").[405] This power can be exercised in particular if there may have been a

[400] FSA, The FCA's use of temporary product intervention rules, p. 31.
[401] The FCA product intervention rules are laid down in COBS 22.
[402] FCA. Temporary Marketing Restriction (contingent convertible securities) instrument 2014. 24 July 2014.
[403] FCA. Restrictions on the retail distribution of regulatory capital instruments , CP 14/23. October 2014 and FCA. Product Intervention (contingent convertible instruments and mutual society shares) instrument 2015. 4 June 2015, 2015/29, The new rules enter into force on 1 July 2015 for mutual society shares and on 1 October 2015 for CoCos (COBS 22.2. (mutual society shares) and COBS 22.3 (Cocos)).
[404] FCA. Restrictions on the retail distribution of unregulated collective investment schemes and close substitutes. Feedback to CP12/19 including final rules, PS13/3. June 2013.. The rules take effect from 1 January 2014. Notably, within the category of retail investors (a person who invests in their capacity as a retail client – that is, a client who is neither a professional client nor an eligible counterparty) the FCA distinguishes between Sophisticated, high net worth individuals and ordinary retail investor.
[405] The rules on the consumer redress scheme are laid down in the FCA CONRED Consumer Redress Schemes sourcebook. The Financial Services Act 2010 gave to the FSA (now FCA) the power to set up the CRD, without the need of the prior authorization from HM Treasury. The Treasury retains the power to widen the scope of the consumer redress scheme, namely by amending the definition of consumers or

widespread or regular failure by relevant firms to comply with regulatory requirements. Under the scheme, the firm can be required to internally investigate alleged breaches of rules, ascertain whether the breach caused a loss to the client and (if so) provide redress to the client.

The CRD is open to both retail and non-retail clients as it comprises every person who has used, or may have contemplated using, any of the services included in the scheme.[406] It follows that a complainant may be eligible for the consumer redress scheme but may not be eligible for the FOS.[407] With regard to the relationship between the CRD and the FOS, it should be recalled that the FCA must consult the FOS (Section 404(9)) and consumers can always submit a complaint to the FOS if they are not satisfied with the firm's determination under the scheme (Section 404B(1)). However, in this case the FOS's lack full jurisdiction and can only decide whether the firm's determination respected the rules laid down by the scheme.[408]

In 2013, despite opposition from the majority of respondents during the public consultation, the FSA started a CRS to compensate consumers who had invested in Arch Cru funds, a high-risk product that typically invested in non-mainstream assets such as private equity and private finance, after founding that that firms recommended consumers invest in this fund without properly assessing their previous experience with such funds and their willingness to take such risks.[409] The scheme applied to firms that had made a *personal recommendation* in relation to an Arch Cru fund, after which a *consumer* made an investment in the Arch Cru fund, and to which the

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firms (s. 404G). This means that a breach of Principles for Businesses, which are not actionable in court, cannot be used to require firms to set up a CRS under section 404. Instead, such a breach would be actionable before the FOS. For more detail, see FSA, Guidance note, 10/2010. 23 July 2010.

[406] Section 404E of the FSMA.

[407] See DISP 2.7.2. FCA Handbook and below, for more details.

[408] See FOS. Response from the FOS to the consultation paper 12/9 on the Arch Cru fund where the FOS, whilst supporting the scheme, warned the FSA that adequate supervisory resources should be deplyed to ensure that firms comply with the scheme's rules. http://www.financial-ombudsman.org.uk/publications/policy-statements/ArchcruCRS-FOSresponse.pdf

[409] FSA. Consumer redress scheme in respect of unsuitable advice to invest in Arch cru funds./24. December 2012.

suitability requirements applied.[410]

Under this scheme, 3,414 sales have been reviewed by firms and 85.4% of these have been found to be unsuitable and, at 27 January 2014, the redress amounts to £31.47 million.[411] As noted by Andenas and Chiu, consumer redress schemes, which are publicly-driven private enforcement mechanisms, not only achieve the 'client protection objective' but also contribute to strengthening the safety and soundness of firms and the stability of the financial system because they avoid potential waves of financial litigation and administrative fines for mis-selling. The consumer redress scheme can be seen thus as a form of increasing paternalism in the client protection regulatory strategy.[412] Therefore, consumer redress schemes can be regarded as a form of *ex post* paternalism precisely because they encourage consumers to seek redress.[413]

6. Convergent trends and divergences

The previous analysis has brought to light convergent trends in the institutional setting and the supervisory approach of the ESAs and the NCAs.

6.1. The rise of the (imbalanced) European twin-peaks supervisory model

From the institutional perspective, there has been a shift from a sectoral towards a

[410] FSA. Arch Cru Funds Consumer Redress Scheme Instrument 2012. 13 December 2012, FSA 2012/77. The scheme entered into force the 1 April 2013 and has no end date. The scheme rules are laid down in CONRED 2.1.1.

[411] https://www.fca.org.uk/news/press-releases/£31m-compensation-be-paid-out-following-fca's-arch-cru-consumer-redress-scheme

[412] See M.Andenas and I. Chiu. *The Foundations and Future of Financial Regulation,* p. 266 who positively assess this paternalism because it ensures that the FCA pursues also the financial stability objective.

[413] For this new interventionist approach of FCA, see http://www.fsa.gov.uk/library/communication/speeches/2012/0125-mw.shtml who acknolwedges, however, that 'financial markets are about the management and pricing of risk, not its removal. It is therefore imperative that intervention does not make for a zero-failure regime, and that investors are not completely absolved of the responsibility for their own decisions.

twin-peaks supervisory model.[414] Some jurisdictions (UK, Belgium) have adopted a pure twin-peaks model, others (Italy, France) have adopted a twin-peaks model with some variations.

One could therefore get the impression that whereas the national supervisory models are organized along the twin-peaks distinction, the EU model is based on a sectoral model.[415] The "law in action", however, reveals a more complicated picture. As reported by the European Court of Auditors, the practice shows a separation of the consumer protection and prudential functions between ESMA and EBA, with the ESMA becoming more involved in the implementation of the MiFID's conduct of business and product governance rules, and the EBA becoming more involved in the implementation of the single rule book.[416] In addition, with the establishment of the SSM a distinction is emerging between conduct of business supervision (always conducted by NCAs) and prudential supervision (conducted by the ECB and implemented by the NCAs, for the less significant institutions).

The emergence of this pan-European twin-peaks model poses the crucial question of how competing supervisory objectives (consumer protection and financial stability) should be balanced and achieved at the supranational context. The question is all the more important because the ESAs Regulation, whilst reiterating the importance of protecting investors/clients/consumers, seem to rank them after the overriding 'financial stability' objective. Also, the difficulty of adopting product restrictive measures and the narrow interpretation of their enforcement powers under Article 17, so as to exclude actions based on private investors' complaints, is illustrative of the

[414] See ECB. Recent developments in supervisory structures in the EU Member States (2007-2010), p. 5 and more recently V. Colaert. 'European Banking, Securities and Insurance Law: Cutting Through Sectoral Lines?' 52 C*ommon Market Law Review* 52 (2015): 1592.
[415] See V. Colaert. 'European Banking, Securities and Insurance Law: Cutting Through Sectoral Lines?', 1592.
[416] According to Article 40(5) of the EBA regulation, when the BoS discusses an item that does not fall within the mandate of the voting NCA, the latter may bring a representative from the relevant national authority who shall be non-voting. However, in 2011 and 2012 no representatives of national consumer protection authorities were present at the Board of Supervisors' meetings when consumer protection issues were discussed. See ECA, Report 2014, Paras 71 and 87 and Commission Report, p. 8.

difficulty for the ESAs to take action against the NCAs and market participants in the context of conduct supervision. There is therefore a risk, given also that consumer protection concerns can be considered by the ECB only if directly relevant for prudential measures, that at the EU level this twin-peaks model is imbalanced and the consumer protection concerns are absorbed into the overriding prudential considerations. The balance between these competing objective can of course be achieved by the NCAs, which have fully-fledged regulatory and supervisory powers to carry out their investor protection objective. In this respect, the foregoing analysis offers some comfort on the capacity of the ESMA to drive, albeit through non-legally binding measures, the action of the NCAs and on the willingness of these authorities to implement these acts also with legally-binding measures (i.e. product intervention).[417] However, it remains to be seen if and how investors can invoke 'soft-law' measures adopted by the EU and national authorities before Union and national courts to draw contractual remedies against the financial firm.[418]

6.2. The formalization of product-related supervisory standards

The NCA and ESMA supervisory approach reflects the regulatory tightening of the conduct and product requirements after the crisis. A common trend across the examined jurisdictions is the supervisory attention on the governance of complex financial products which is expressed mainly through a risk-based approach and non-restrictive ('soft law') measures.

Although the NCAs have increasingly made use of thematic reviews (especially on the MiFID conduct requirements and product regulation),[419] their supervisory approach remains risk-based. This approach, whilst functional to efficiently allocate supervisory resources, could overlook potential breaches or misconduct.[420] The effectiveness of

[417] See E. Ferran. 'The Existential Search of the European Banking Authority', 303.
[418] See Chapter 8, below.
[419] ESMA, MiFID – Conduct of Business, fair, clear and not misleading information, 13.
[420] ESMA, Follow-up Report to the Peer Review on MiFID Conduct of Business rules relating to fair, clear

risk-based supervision is also dependent on the right calibration between *ex ante* and *ex post* as well as off-site and on-site supervisory actions. The CNMV and the AMF intensified their *ex ante* reviews of marketing documentation based on forward-looking indicators, whereas the CONSOB and FCA's approach remains based on *ex post* review of marketing documentation.[421]

In the examined NCAs there is a balance off-site and on-site activities. In Italy, France and Spain on-site inspections are conducted on the basis of biannual/annual work plans, whereas in the UK they are mostly based on an *ad hoc* basis, in reaction to specific issues or suspected irregularities emerging from ongoing supervision.[422] This backward-looking or 'complaint-led' approach underlines the importance of integrating the complaint and dispute resolution functions within the supervisory authorities but at the same time reveals the risk of lack of systemic precautionary approach to conduct and product risks. Whilst the prevalence of non-restrictive measures suggests that the NCAs and ESMA prefer an informal and more responsive supervisory approach, there are also signs showing a formalization of supervisory standards, namely the incorporation of standards into legal acts that are either coercive (e.g. instructions) or, more often, non-coercive (e.g. communications).[423]

6.3. The standardization of contract terms

One of the main implications of the formalization of product-driven supervision is the increased intrusiveness of supervision into private law relationships. Indeed, these supervisory measures not only affect the conduct of market particpants but also the content of their contracts, namely by specifying the technical characteristics of financial instruments and products. It is submitted that formalized supervision can lead to the standardization of contract terms either by way of outright restrictions of

and not misleading information.
[421] ESMA, MiFID – Conduct of Business, fair, clear and not misleading information, 14.
[422] ESMA, MiFID – Conduct of Business, fair, clear and not misleading information, 27.
[423] See Y. Svetiev, A. Ottow. 'Financial Supervision in the Interstices Between Private and Public Law', p. 542.

financial products (product intervention) or, more frequently, through non-restrictive measures, quasi-regulatory acts (guidelines, draft technical standards) which, despite the lack of legally binding effects, can *de facto* create a presumption of non-conformity of certain financial instruments with the relevant EU law.

This 'conformative' effect can be compared to that deriving from the 'New Approach' adopted by the EU in areas of technical harmonization to facilitate trade within the EU single internal market.[424] Under this 'New Approach', EU Directives lay down 'essential requirements' of EU Directives are subsequently detailed into technical requirements by private standardization organizations, and published by the Commission as harmonized standards. There is no obligation for manufacturers to apply these standards but there is a rebuttable presumption that products which conform to the harmonized standards also fulfil the essential requirements of the corresponding directives.[425]

Although the financial product standards do not expressly provide for this presumption mechanism and they are not endorsed by the Commission (except for those included in DTS), they can *de facto* acquire a similar level of prescription because they are drafted by public authorities (not private organizations) entrusted with the protection of 'public values' which remain also responsible for their implementation and enforcement. The different question is of course whether the non-compliance with these standards can have effects in the private law relationship between firms and client.[426]

[424] Council Resolution 85/C of 7 May 1985 on a new approach to technical harmonization and standards. See for an overview B. Van Leeuwen, The EU's approach to goods and private law claims in the aftermath of PIP breast implant scandal, in G. Comparato, H.-W. Micklitz, Y. Svetiev *European Regulatory Private Law : Autonomy, Competition and Regulation in European Private Law.*, p. 141 ss.

[425] See in more detail Opinion of AG Trstenjak in case C‑171/11, Fra.bo SpA, ECLI:EU:C:2012:176, para 19.

[426] See Chapter 8, Section 2.3., below.

Chapter 5 – THE OUT-OF-COURT DISPUTE RESOLUTION OF FINANCIAL DISPUTES

1. The ADRs in the institutional context

After the global financial crisis, the development of out-of-court dispute resolution has become a key priority of the international and EU retail regulatory agenda. The OECD recommended national jurisdictions to ensure that 'consumers have access to adequate complaints handling and redress mechanisms that are accessible, affordable, independent, fair, accountable, timely and efficient'.[427] The EU, which since the 1999 FSAP–Directives has encouraged Member States to establish ADRs, after the crisis, with the MiFID II introduced very important innovations regarding the out-of-court resolution of financial disputes and the extra-judicial private enforcement of conduct regulation (Article 69 and 75).

The MiFID II innovations complement the general framework for consumer ADR laid down in 2013 by the ADR Directive and the ODR Regulation[428] and support the recent Commission's initiatives to strengthening of ADRs for financial-related disputes.[429] At the national level, instead, ADRs in the financial sector have been mostly regarded as an emergency and scandal driven measure but after the global financial crisis there is a trend towards a more systemic approach in the establishment and regulation of this private enforcement mechanism. In light of this evolving legal framework, this chapter aims to understand the role played by the out-of-court dispute resolution in the governance of financial transactions. The widespread mis-conduct by credit and

[427] OECD, G20 High-level Principles on Financial Consumer Protection. October 2011 (9th principle entitled 'Complaints Handling and Redress').
[428] Directive 2013/11/EU of the European Parliament and of the Council of 21 May 2013 on alternative dispute resolution for consumer disputes OJ L 165/63 (2013) (Directive on consumer ADR) and Regulation (EU) No 524/2013 of 21 May 2013 of the European Parliament and of the Council on online dispute resolution for consumer disputes OJ L 165/1 (2013) (Regulation on consumer ODR).
[429] Commission. Green Paper on retail financial services: better products, more choice, and greater opportunities for consumers and businesses. Brussels, 10.12.2015 COM(2015) 630 final and Commssion. Study on the role of digitalisation and innovation in creating a true single market for retail financial services and insurance. June 2016, FISMA/2015/075D.

investment firms experienced between 2008 and 2012, often in correlation to firms' crisis and bankruptcies, have increased the clients' recourse to out-of-court dispute resolution mechanisms. It is submitted that these mechanisms, which traditionally aim at resolving informally clients' disputes, have increasingly become 'quasi-supervisory' and/or 'quasi-judicial' tools to ensuring the compliance and effectiveness of EU financial regulatory standards and, in some cases, national contract law.

To test the validity of this argument, this chapter undertakes a comparative analysis of the different institutional setting, tasks and powers of the ADRs established in Italy, France, Spain and the UK. In addition, particular attention will be devoted to the 'adjudicative approach' of the ADRs, namely the modes through which the ADR scheme, either facilitative or adjudicative, resolves the disputes.

2. The out-of-court dispute resolution before the crisis

2.1. The FIN–NET network

The out-of-court resolution of financial disputes aims to both provide fast, efficient and informal redress to clients, like the consumer ADRs, and to increase clients' confidence in financial markets, thereby strengthening market stability. Recent research has found a correlation between financial firms' misconduct, loss of investor confidence in financial markets and systemic risk (e.g. due to withdrawal of deposits, widespread sales of assets).[430] Therefore, the rapid and effective 'rectification', through judicial and extra-judicial proceedings, of this misconduct can contribute to restoring investor confidence in financial markets and preventing potential sytemic risk.

To this end, in 2001 the Commision launched an out-of-court complaints network, FIN–NET, to facilitate the fast and effective out-of-court resolution of consumer disputes when the financial firm is established in an EU Member State other than that

[430] ESRB. Report on misconduct risk in the banking sector, p. 7.

where the consumer lives.[431] Once a consumer files a complaint against a financial firm in a different country, FIN–NET identifies the relevant ADR scheme in that country, provides the consumer information on the procedure and transfers the consumer's complaint to the relevant ADR scheme. The condition to adhere to the FIN–NET is the acceptance of a Memorandum of Understanding (MoU) which requires, *inter alia*, the participating ADR bodies to resolve the dispute according to the ADR Directive or, where appropriate, the Commission Recommendation No 98/257.[432] The FIN–NET, therefore, not only has a procedural impact on cross-border dispute resolution but also an important substantive impact because it requires the participating ADR bodies to apply the Directive on consumer ADR for the resolution of financial disputes.

The statistical data available show that the number of schemes participating to FIN–NET and the number of complaints handled has steadily increased between 2001 and 2014. Whilst in 2001, FIN NET included 38 members and handled 335 complaints,[433] at the end of 2014, FIN–NET had 57 members and handled 3, 514 cross-border cases. Another important aspect of the functioning of FIN–NET, is that over the last decade the number of cases related to investment services, in comparison to banking and insurance services, has increased.[434] However, the complaints are not proportionally distributed among its members. In 2009 only five ADRs dealth with the 85% of the complaints handled.[435]

Taking into account the fact that these data reflect only the recourse to FIN–NET, and not the recourse to national ADRs, these data confirm that the consumers' recourse to

[431] Commission, IP/01/152, February 2001.
[432] Memorandum of Understanding on a Cross-Border Outof-Court Complaints Network for Financial Services in
the European Economic Area, as amended on 12 May 2016. Available at http://ec.europa.eu/finance/fin-net/docs/mou/en.pdf
[433] Commission, Evaluation of FIN-NET. Final report, June 2009. Available at http://ec.europa.eu/finance/fin-net/docs/evaluation_en.pdf.
[434] See Commission, FIN-NET activity report 2013 – 2014, Brussels, December 2015 http://ec.europa.eu/finance/fin-net/docs/activity/2013-2014_en.pdf
[435] hodges, 16.

ADRs after the financial crisis has constantly increased.[436] In addition to this, the increasing recourse to FIN–NET shows also a gradual increase of retail cross-border transactions, even if the level of these transactions remains low.[437] In the 2015 the Commission announced its intention to give "early priority" to initiatives aimed at increasing the awareness of FIN-NET among EU citizens.[438]

2.2. The out-of-court in the FSAP legislation

The development of the FIN–NET has been supported by several legislative measures, enacted during the FSAP era (1999-2008), which introduced a minimum harmonization of ADR procedures in the financial sector.

Some Directives (Distance marketing financial services directive,[439] MiFID I and UCITS IV Directive) 'encouraged' Member States to set up ADRs, others required Member States to set up ADR procedures (consumer credit directive, payment service directive[440], UCITS directive[441], e-money directive[442]). The impact of these FSAP-Directives on the harmonization of ADRs in the EU remains, however, very limited because they do not lay down any specific procedural or institutional requirement for

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[436] See See Commission, Evaluation of FIN-NET. Final report, June 2009. Available at http://ec.europa.eu/finance/fin-net/docs/evaluation_en.pdf; Commission, Study on the use of Alternative Dispute Resolution in the European Union (DG SANCO). Final Report, October 2009, p. 15. See also See N. Moloney. *How to Protect Investors? Lessons from the EC and the UK*, 2010, p. 457 and I. Chiu. *Regulatory Convergence in EU Securities Regulation*, Kluwer, 2008, p. 160.

[437] Eurobarometer, Retail financial services. Special Eurobarometer 373, March 2012: the 94% of consumers have never entered into cross-border financial transactions. See also Special Eurobarometer 446, July 2016, available at: http://ec.europa.eu/COMMFrontOffice/PublicOpinion/index.cfm/Survey/getSurveyDetail/instruments/SP ECIAL/surveyKy/2108

[438] Commission. Green paper on retail financial services Better products, more choice, and greater opportunities for consumers and businesses" COM/2015/0630 final, p. 21.

[439] Article 14 of the Directive 2002/65/EC of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services OJ L 271/1 (2002).

[440] Article 83 of the Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market OJ L 319/2 (2007).

[441] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) (recast) (Text with EEA relevance) (OJ L 302, 17.11.2009)

[442] Article 13 of the Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions OJ L 267/10 (2009).

the ADR mechanism.[443] The pre-crisis Directives have put more emphasis on the firm's internal complaints handling procedures. The Commission MiFID I Directive (Article 10) and the UCITS implementing Directive (Article 6)[444] required Member states to ensure that investment firms investment establish, implement and maintain effective and transparent procedures for the reasonable and prompt handling of complaints received from retail clients or potential retail clients, and to keep a record of each complaint and the measures taken for its resolution. Similarly, in the banking sector, the Payment Services Directive (Article 83), the E-Money Directive (Article 3(1))[445] and recently the CRD IV (Article 74) and the PRIIPs Regulation (Article 19) require credit institutions, payment institutions and electronic money institutions to strengthen internal governance arrangements which also include internal complaints handling procedures. An effective internal complaints management functions in credit and investment firms is cricual for micro-prudential purposes. These complement that of the compliance function, namely to ensure that the firm keeps the potential sources of conduct risk under strict monitoring and control.[446]

3. The out-of-court dispute resolution after the crisis

3.1. The ADR Directive and the ODR Regulation: Principal innovations

The Directive on consumer ADR and the Regulation on consumer ODR, adopted on the basis of Article 114 of the TFEU, aim at ensuring a high level of consumer protection in accordance with Article 169 of the TFEU. The ultimate objective is to strengthen the functioning of the internal market (e.g. through online and offline cross-border transactions). Whereas the Regulation introduces an online platform for the resolution

[443] The Distance marketing and consumer credit directive require the financial firm to disclose whether or not there is an out-of-court complaint and redress mechanism for the consumer that is party to the distance contract and, if so, the methods for having access to it (Article 3 (4); Article 10 (2)).
[444] Commission Directive 2010/43/EU implementing Directive 2009/65/EC OJ L 176/42 (2010).
[445] Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money OJ L 267/7 (2009).
[446] See also EIOPA. Guidelines on Complaints Handling by Insurance Undertakings, EIOPA_BoS_12/069, June 2012 and ESAs, Joint Committee Consultation Paper on draft guidelines for complaints-handling for the securities (ESMA) and banking (EBA) sectors, JC-CP-2013-03, November 2013.

of consumer disputes in online contracts for sale of goods or services, the Directive harmonizes existing laws establishing ADR schemes, either facilitative or adjudicative, for the resolution of disputes over contracts for the sale of goods and services.

In the recent *Menini* judgment the CJEU clarified that the ADR Directive does not apply to all consumer disputes but only to those which met the requirements of Article 2 of the Directive.[447] Within this scope, the Directive (as well as the Regulation) can apply to disputes involving investment services where one of the parties is a consumer (natural person acting outside his or her businesss, trade, business, craft or profession). Importantly, the CJEU established, in line with the landmark *Alassini*[448], that the ADR Directive does not preclude a national legislation (in this case the Italian law) requiring the mandatory attempt of mediation as a condition for the admissibility of the legal proceeding, if "such a requirement does not prevent the parties from exercising their right of access to the judicial system".[449] The need to ensure the effectiveness of this right, however, precludes according to the CJEU, a national legislation which provides that consumers may withdraw from a mediation procedure only in the event that they demonstrate the existence of a valid reason in support of that decision.[450]

The most important novelty of the ADR Directive is to transform the seven principles of Recommendation 98/57 (independence, impartiality, transparency, effectiveness, fairness, liberty, legality) into legally-binding principles that shall be respected, as a minimum requirement, by Member States. In this regard, the Directive requires ADR bodies to respect the principle of legality. This means that, while the ADR itself is not bound by legal rules and principles, the solution imposed on the consumer cannot lead to a reduction of the level of protection granted to him or her by national mandatory law.[451] In addition, according to its Article 9(2) before agreeing or following a

[447] Case C-75/16, *Menini*, ECLI:EU:C:2017:457, para 56.
[448] Joined cases C-317/08, C-318/08, C-319/08 e C-320/08, *Alassini and Others* EU:C:2010:146, para 45.
[449] Case C-75/16, *Menini*, para 71.
[450] Case C-75/16, *Menini*, para 71.
[451] See recital No 19 and principle V of the Commission Recommendation 98/257/EC of 30 March 1998

proposed solution the parties shall be informed, *inter alia*, that the proposed solution may be different from an outcome determined by a court applying legal rules. One possible rationale of this specification is that, as a general rule, the ADR should lead to a solution that approximates the solution that a court would reach through the application of legal rules. The practical effect of this provision could be to strengthen the tendency of ADR to follow legal rules when resolving disputes in order to enhance the 'authoritative' character of the solution proposed to or imposed on the parties and provide more incentives for the parties to accept and comply with that solution.

3.2. The MiFID II

The MiFID II introduced several regulatory innovations to strengthen the out-of-court resolution of retail financial disputes. First, it requires – and it does not only encourage, like the MiFID I – Member States to establish ADR procedures to settle consumer disputes and to ensure that all investment firms adhere to one or more such bodies implementing such complaint and redress procedures. It also requires that those bodies actively cooperate with their counterparts in other Member States in the resolution of cross-border disputes (Article 75(1)). Second, the MiFID II further requires ESMA to publish and keep an up-to-date list of all extra-judicial mechanisms on its website but does not confer any dispute resolution power to this Authority (Article 75(3)).[452] However, the ESAs recognize the importance of out-of-court dispute resolution. Their websites inform the retail clients that they can obtain redress through a three-step process: contact the firm, submitting formal complaint to the firm and submitting complaint to ADR.[453] Third, and most importantly, the MiFID II requires Member States to establish mechanisms to ensure that compensation can be

on the principles applicable to the bodies responsible for out-of-court settlement of consumer disputes, OJ L 115/31 (1998) and Article 11 of Directive on consumer ADR.

[452] The competent authorities shall notify ESMA of the complaint and redress procedures referred to in paragraph 1 which are available under its jurisdictions.

[453] See ESMA website (https://www.esma.europa.eu/investor-corner/file-complaint); EBA website (http://www.eba.europa.eu/consumer-corner/how-to-complain); EIOPA website (https://eiopa.europa.eu/complaints/complaints-against-a-national-competent-authority)

paid or other remedial action be taken in accordance with national law for any financial loss or damage suffered as a result of an infringement of this Directive or of Regulation (EU) No 600/2014 (Article 69).[454] This provision is extremely important because it introduces, for the first time in EU law, the principle that a breach of EU financial regulation shall be compensated with (extra-judicial) private enforcement. Unlike Article 75 which refers to out-of-court mechanism to settle disputes, Article 69 expressly links a private law remedy (compensation) to the loss caused by the infringement of EU financial regulatory standards and therefore makes it clear that Member States must establish rules for the private enforcement (and not only dispute resolution) of financial regulation.[455]

4. The national models

Without prejudice to the EU law requirements examined above, Member States remain free to establish ADR procedures as they see fit, subject to the principle of equivalence and effectiveness. In addition, as the CJEU held in the landmark *Alassini*[456], and in the recent *Menini*[457] ADRs must comply with the fundamental right of effective judicial protection. To assess how the national ADR bodies enforce EU conduct standards and what the impact of their adjudication approach to national private law is, the next sections will (i) illustrate the national institutional context for the financial sector-ADRs; (ii) the competence, tasks and powers of these ADRs; and (iii) the patterns disputes and adjudicative approach (e.g. legalistic[458], formalistic[459], informal[460]).

[454] For more detail on this provision, see F. Della Negra. 'The Effects of the ESMA's Powers on Domestic Contract Law' M. Andenas, G. Deipenbrock (eds.), Regulating and Supervising European Financial Markets, p. 155.
[455] Significantly, Article 69 is located under the provision named 'supervisory powers'.
[456] Joined cases C-317/08, C-318/08, C-319/08 e C-320/08, *Alassini and Others*, para 45.
[457] Case C-75/16, *Menini*, para 55.
[458] A legalistic approach indicates that decisions are based on private law rules and case law.
[459] A formalistic approach indicates that decisions are based on the documents submitted by the parties (e.g. contract)
[460] An informal approach means that decisions are taken on the basis of the parties' conduct and equitable principles.

4.1. Italy

4.1.1. Institutional framework

The Italian system of ADR for financial and banking disputes was established in the aftermath of the default of Parmalat, Cirio and the Republic of Argentina to restore the confidence of retail investors in financial markets and introduce a fast, cheap and effective mechanisms for out-of-court dispute resolution.[461] The system is based on public-based and public-funded ADRs established within the national supervisory authorities – the Arbitro Bancario Finanziario ("ABF") in Banca d'Italia and the Arbitro per le controversie finanziarie ("ACF") in CONSOB – and a private ADR, established in 1993 by the Italian Banking Association (Ombudsman-giurì bancario). According to the Legislative Decree 28/2010, the admissibility of actions before national courts regarding commercial contracts, including financial and banking contracts, is conditional upon an attempt to settle the dispute out of court and this condition can be met through recourse to the ABF, ACF or other ADR mechanisms (e.g. mediation).[462]

4.1.2. Arbitro bancario finanziario ('ABF')

A) Competence, tasks and powers

The ABF was established in 2008 and became operational on 1 January 2010. It is responsible for the adjudication of disputes between firms and clients regarding banking contracts and services.[463] The supervised entities must adhere to the ABF in

[461] Article 27(1) of the Law 262/2005 introduced ADR in the field of banking services, within the Banca d'Italia (Article 29(1)) and delegated the Government to establish ADR in the field of investment services (Article 27(1)).

[462] Article 5(1) of the Legislative Decree 28/2010. See in detail G. De Palo, L. Keller. 'Mediation in Italy: Alternative Dispute Resolution for All' in K. J. Hopt and F. Steffek (eds.). Mediation: Principles and Regulation in Comparative Perspective, Oxford, Oxford University Press, 2012, p. 430. See also F. Della Negra. 'Le controversie in materia consumeristica. Strumenti di composizione: negoziali e non negoziali', in P. Gianniti (ed.). *Processo civile e soluzioni alternative delle liti tra privati. Verso un sistema di giustizia integrato*, Aracne, 2016, p. 741.

[463] Comitato Interministeriale per il Credito ed il Risparmio (CICR), Deliberazione 29 luglio 2008 n. 275. Disciplina dei sistemi di risoluzione stragiudiziale delle controversie con la clientela ai sensi dell'art.

order to carry out their business. The ABF is part of the banking supervision department of the Banca d'Italia and is currently organized through seven local panels and a central body which coordinates the activities of these panels.[464] The local panels are supported by the technical secretariats (segreterie tecniche) which examine the applications and provide legal support to the activity of the panels. The panels are composed by three members, appointed by the Banca d'Italia, one member appointed by the banking intermediries and one member appointed by consumer organizations. The Banca d'Italia is also responsible for preparing the ABF's annual report and publishes on its website whenever a financial firm fails to comply with the decisions of the ABF.[465] During 2014 numerous supervisory actions have been based on the data available from the ABF's proceedings such as, for example, a systematic review review on the unilateral amendment in banking contracts.[466]

The complainant can be a natural and legal person provided that he or she does not exercise a professional activity in the field of banking, finance or insurance services[467] and must have already submitted a complaint to the respondent's internal complaint handling office.[468] The parties can submit written observations and the panel shall decide the dispute within two months from the financial firm's observations (Article 6 (1)). The ABF has the power to grant compensation up to EUR 100,000 for losses suffered by the client as a result of the firm's breach of rules, excluding losses which are not a direct consequence of the infringement. The ABF shall take its decision based

128-bis d.lgs. 385/1993 (Gazzetta Ufficiale n. 222 del 2008); Bank of Italy, le disposizioni adottate dalla Banca d'Italia il 18 giugno 2009 e pubblicate nella Gazzetta Ufficiale n. 144 del 2009; Bank of Italy, Disposizioni sui sistemi di risoluzione stragiudiziale delle controversie in materia di operazioni e servizi bancari e finanziari, November 2012. Segnalazioni dei prefetti. The prefetto can inform the ABFabout alleged violation of the conduct of business rules by the banks in carrying out financing operations.

[464] Originally, the ABF had three local panels (in Milano, Roma, Napoli). Since 2016, new panels have been established in Torino, Bologna, Bari and Palermo).

[465] See C. Consolo, M. Stella. 'L'"arbitro bancario finanziario'' e la sua ''giurisprudenza precognitrice' 2 Le società, (2013): 190.

[466] Banca d'Italia. Annual report on the ABF 2015, 15.

[467] See ABF, Decision n. 7366/2014 (in Annual report 2015, 65).

[468] The ABF cannot decide disputes that have already been decided or referred to courts, arbitration and other ADR entities.

on the documentation of the case, the legal rules, financial regulation and the code of conduct applicable to the financial firm.[469]

The ABF's decisions are not legally binding and do not preclude the parties' access to courts. However, the financial firm's failure to comply with the decision within 30 days is published on the website of the ABF.[470] Therefore, whilst the ABF does not play mere administrative/functions, because it takes decisions to solve disputes, it cannot be regarded as a judicial or arbitration body because it decisions are not binding and enforceable and do not prejudice the parties' access to courts.
To conclude, the procedure is essentially free of charge for the client[471] and the decisions are publicly available in full on the ABF's website.

B) Patterns of disputes and adjudicative approach

The litigation before the ABF is based on disputes arising out of banking contracts (i.e. credit cards, consumer loans, mortgage loans or any other legally relevant relationship with the bank). The ABF's adjudicative approach reveals a strong adherence to the principles of national private law, procedural law and the case law of Italian courts. For example, in line with recent case law of the Supreme Court, the ABF in fact acknowledged that the bank is liable under contract law whenever there is a 'socially-qualified contact' *(contatto sociale qualificato*) with its client, irrespective of the fact that the parties did not enter into a contract.[472] In addition to this, in numerous decisions the ABF, by expressly referring to the case law of the Supreme Court,[473] held that the bank, in accordance with the duty of good faith, should adopt whatever

[469] See A. A. Dolmetta. *Trasparenza dei prodotti bancari. Regole*. Bologna, Zanichelli, 2013.
[470] The Italian Constitutional Court decided that the ABF does not exercise any jurisdictional function and cannot refer questions to it because, although it is established on legislative basis, its functioning is regulated by administrative measures, and therefore cannot be regarded as a truly independent, super partes, adjudicator (order, 21 July 2011, n. 218).
[471] The client must pay EUR 20 for the procedure's cost but this sum shall be reimbursed to the client if the complaint is successful.
[472] See Cass., 13 May 2009, n. 11130.
[473] See, *inter alia*, Cass. 28 September 2005 n. 18947 and Cass. 11 January 2006 n. 264.

conduct it is necessary in order to protect the interests of the other party, notwithstanding the specific obligations set out in the contract.[474] On that basis, the ABF has compensated clients for the loss suffered as a result of the bank's refusal to allow withdraw from the deposit' account,[475] for the bank's refusal to cancel the contract after the full performance of the obligations arisen out of the loan contract,[476] and for the bank's refusal to cancel the contract when the client had communicated the withdrawal by means of email instead of a written communication as specified by the contractual documentation.[477]

In an important decision the ABF made several references to the landmark *Banco Español de Crédito SA*[478] where the CJEU decided that the national court's finding that an unfair term cannot lead the court to revise the content of that term. On the basis of this principle, the ABF declared the nullity of an unfair contract term in a consumer credit contract but, partially departing from that principle, decided that the unfair term shall be replaced by the maximum statutory interest rate (Article 1224 c.c.). The ABF reasoned that since the statutory interest rate is much lower than the contract-based rate laid down by the bank, it does not deprive the Directive 1993/13 of its dissuasive effect.

It is also worth noting that in recent judgments some Tribunals (first instance courts) have expressly referred to the ABF's decisions in relation to disputes on interest rate clauses in mortgage contracts. In one case the Tribunal of Napoli,[479] in dismissing the client's claim, held that in line with the decisions of the ABF[480] and the Supreme Court[481] the statutory limitations to the interest rate cannot be calculated as the sum

[474] See, inter alia, ABF, Coll. Roma, Decision n. 7807, 21 November 2014; ABF, Coll. Roma, Decisione n. 7338, 3 November 2014.
[475] ABF, Coll. Roma, Decision n. 2269, 14 April 2014.
[476] ABF, Coll. Roma, Decision n. 3178, 12 June 2013.
[477] ABF, Coll. Napoli, Decision n. 867, 28 April 2011.
[478] Case C-618/10, *Banco Español de Crédito SA*, ECLI:EU:C:2012:349.
[479] Trib. Napoli, sez. II, 15 April 2014.
[480] ABF, Coll. Coord., Decision n. 1875, 28 March 2014; Decision n. 3412, 23 May 2014; Decision n. 3955, 24 June 2014.
[481] Cass., 9 January 2013, n. 350.

between ordinary and default rates but it refers, separately, to the two types of interest rates normally provided by loan agreements.

4.1.3. The Ombudsman-giurì bancario ("Ombudsman")

A) Competence, tasks and powers

The Ombudsman is a private ADR established in 1993 by the Italian Bank Association.[482] In 2005 the organization established a new association named Conciliatore Bancario Finanziario – Associazione per la soluzione delle controversie bancarie, finanziarie e societarie – ADR. The association includes 1150 members – banks, investment firms, funds and trade associations – and is responsible for the functioning of a mediation, arbitration and Ombudsman scheme.[483]

The Ombudsman resolves the disputes through a panel composed by a President, appointed by the Council of State, and four members appointed by the Conciliatore Bancario Finanziario, and designated by consumers and banking associations. The panel members must respect requirements of experience, compentence and independence.[484] The Ombudsman is competent regarding disputes related to investment services concerning both retail and non-retail clients. To be admissible, the complaint must relate to an infringement occured within two years from the date of the alleged violation (the time-limit is one year for complaints before the ABF and ACF) and the complainant must have already submitted a complaint to the firm's internal complaints handling and must not have been submitted to other ADR entities or courts.

[482] For an overview on the private ADRs in the field of Banking and investments services see G. Alpa. 'ADR and Mediation: the Italian experience' 3 European Business Law Review (2008): 888.
[483] Ombudsman-Giurì bancario. Regolamento per la trattazione dei reclami e dei ricorsi in materia di servizi e attività di investimento. Ottobre 2009.
[484] The four members shall be appointed among the members of the Consumers Associations, Customers Association and two of them aming the Italian Banking Association.

Additionally, the Ombudsman must take a decision within 90 days. The rules of procedure do not specify whether the Ombudsman shall follow legal rules. The solely provide that the decision must be taken on the basis of the documentation submitted by the parties. The Ombudsman can grant compensation up to EUR 100,000 and can also declare the contract null and void and order restitution. The decision is not legally binding on the parties and cannot be enforced. However, the firm's failure to comply with the decision is published in the national press at the respondent's expense. The Ombudsman publishes a report on its annual activity which includes the extract of the most relevant decisions.[485]

B) Patterns of disputes and adjudicative approach

The statistical data available show a constant increase of the number of complaints submitted to the Ombudsman.[486] Between 2010 and 2013 approximately 4,300 complaints were submitted to the Ombudsman.[487] Among these, however, almost 2,400 (55%) were dismissed for procedural reasons. In cases where a decision has been issued, the Ombudsman ruled in favour of the investor in 935 cases (40% of the cases admitted; 21.7% of the total cases referred to the Ombudsman).[488]
The disputes are centred on the alleged breach of the suitability or appropriateness rule laid down by Italian law transposing the MiFID regarding the distribution of Lehman Brothers products,[489] Icelandic and Greek sovereign bonds [490] and recently illiquid financial products to retail clients.

The Ombudsman has adopted a formalistic adjudicative approach namely by focussing

[485] Since 2014 the Conciliatore BancarioFinanziario publishes a journal ('repertorio') and the extract of the most important decisions per year ('massimario'). The subsequent references to decisions can be found on the massimario.
[486] See G. Sangiorgio. 'Problemi della pratica un esempio di giustizia 'domestica' alternativa a quella dell'a.g.o.: l'ombudsman - giurì bancario' 3 Banca Borsa Titoli di Credito (2009): 344.
[487] 1079 complaints were submitted in 2013; 1172 in 2012; 612 in 2011; and 1491 in 2012 (data provided by the Secretary of the Financial Ombusman).
[488] Decisions in favour of the client were: 108 in 2013; 99 in 2012; 167 in 2011; and 561 in 2010.
[489] The Ombudsman ruled in favour of the clients in 12 cases out of 17 cases. See Ombudsman. Annual report for 2010 and 2011.
[490] The Ombudsman ruled in favour of the clients in 22 cases out of 26 cases. See Ombudsman. Annual report for 2012.

on whether the nature and risk of the financial instrument distributed by the firm corresponds to the client's profile as defined by the self-compiled MiFID questionnaire. However, in contrast with the ABF, the Ombudsman's approach is less legalistic, because it gives less importance to the interpretation of private law principles in its adjudication.

In non-advised services, the Ombudsman has consistently held that the bank cannot be held liable for the loss suffered by the client as a result of the investment if the client declared in the MiFID questionnaire that he or she had knowledge and experience in investment services.[491] Even if a client was not informed about the illiquid nature of financial instruments, but declared he or she has knowledge and experience in financial investment, he or she cannot be compensated for the loss suffered for the breach of suitability rule.[492] With regard to advised services, the Ombudsman held that, in the absence of any express contractual provision, the investment firm does not owe any client who had knowledge and experience in financial investments a duty to ensure a specific performance of the transaction (*obligation de resultat*) but only a general duty to act in good faith (*obligation de moiens*).[493]

As to the remedies for the breach of conduct of business rules, in cases concerning Lehman Brothers products, sovereign bonds and illiquid products, the Ombudsman has consistently held that the lack of suitability[494] or appropriateness[495] test determines the absolute nullity of the contract and the consequent restitution of purchase price of the financial instrument to the client.[496] Instead, when the suitability or appropriateness test has not been properly carried out (i.e. because some

[491] Decision of 27 January 2016, n. 786/2014; decision of 27 October 2014, n. 548/2013.
[492] Decision of 13 June 2016 n. 159/2016.
[493] Decision of 12 September 2012 n. 180/2012 and n. 671/2012.
[494] Decision of 26 June 2013, n. 119/2013, n. 175/2013, n. 175/2013, decision of 25 January 2013 n. 875/2012.
[495] Decision of 13 February 2012, n. 1029/2012 and decision of 15 March 2012, n. 352/2013.
[496] Notably, in the disputes regarding Lehman Brothers products the Ombudsman declared the nullity of the contracts despite the landmark judgments of the Supreme Court of 19 December 2007, n. 26724 and 26725, which denied that the breach of conduct rules causes the contract to be null and void. See Chapter 6, below.

information is not given or requested to the client), the Ombudsman has decided to compensate the client for the difference between the value of the securities at the purchase and their value at the moment of submission of the complaint.[497] The Ombudsman does not make a distinction between reliance and expectation damages but identifies the loss on the basis of this general criterion, supplemented by the consideration of the specificities of the dispute.[498] However, the Ombudsman has not compensated non-economic losses deriving, in particular, from 'pain and suffering'[499] or 'loss of time' due to the research made by the client to understand information provided by the intermediary[500] or to the time needed for the preparation of the complaint[501] or the delay in the redemption of units[502].

Therefore, it is interesting noting that whilst the Ombudsman has followed a formalistic-documental approach in the assessment of firms' compliance with conduct of business rules, it adopts a more flexible and less legalistic approach than the ABF when deciding what remedies must be granted to the client for the loss suffered as a result of the firm's breach of conduct of business rules.

4.1.4. Arbitro per le controversie finanziarie ("ACF")

A) Competence, tasks and powers

On 9 January 2017 the ACF replaced the CONSOB's Camera di conciliazione e arbitrato, which was established in 2007 to resolve retail clients' disputes through a mediation or arbitration scheme.[503] The ACF is designed on the model of the ABF and is

[497] Decisione of 27 January 2016, n. 653/2015.
[498] See Ombudsman. Annual report for 2011 and 2012.
[499] Decision of 25 January 2013, n. 677/2012.
[500] Decision of 28 June 2012, n. 427/2012 and n. 299/2012; decision of 10 October 2012, n. 299/2012.
[501] Decision of 26 February 2013, n. 876/2012.
[502] Decision of 25 January 2013, n. 677/2012.
[503] Legislative Decree No 179 8 ottobre 2007, n. 179 adopted based on the Law 262/2005. The rules of procedures have been laid down in the CONSOB Regulation No 16763/2008. As for 17 January 2012, 284 requests for mediaiton were submitted to the mediaiton chamber (71% in favour of the client), and no requests for arbitration. This ADR procedure was subsequently amended by the CONSOB, Regulation

responsible for the resolution of disputes between retail clients and investment firms on the MiFID's conduct of business rules, including cross-border disputes and disputes arising from online contracts as defined by the ODR Regulation. Since the compentence of ACF will overlap with that of the Ombudsman, the latter decided to cease its activity.

The ACF decides through a panel composed of three members appointed by the CONSOB and two members chosen by the associations of investment firms and retail clients, respectively.[504] Panel members must respect requirements of competence, experience and, unlike the ABF panels, also a requirement of independence. The panel is supported by CONSOB's secretariat. The procedure is free of charge for the client[505] and must be concluded within 90 days (60 days for the ABF). Prior unsucccessfull recourse to the firm's internal complaint handling is a conditional of access to the ACF.[506]

The ACF can grant compensation up to EUR 500,000 for losses suffered by the client as a result of the firm's breach of rules, excluding the losses which are not a direct consequence of the infringement. Unlike the ABF, the ACF cannot grant compensation for non-pecuniary losses. The ACF shall take its decision on the basis of the legal rules, the acts of general application of CONSOB and – importantly – ESMA and the guidelines of associations approved by CONSOB and codes of conduct applicable to the financial firm. An important difference, in comparison to the ABF, is that in the procedure before the ACF the burden of proof is reversed: it is up to the financial firm to prove compliance with the conduct of business rules (fairnesss, transparency and information) owned to the clients.

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n. 18275/2012 adopted on 18 July 2012. The CONSOB, delibera n. 19602 del 4 maggio 2016 replaced the Camera di conciliazione ed arbitrato with the ACF.

[504] Unlike the members the ABF's panels, those of the ACF's panels must respect an independence requirement.

[505] The financial firm, instead, must pay a lump sum between EUR 400 and 600 if the client's claim is upheld.

[506] The complaint shall be submitted to the ACF, like the ABF, within one year from the unsuccessfull recourse to the firm's internal complaint handling.

The decision of the ACF is not legally binding on the parties and cannot be enforced. However, the firm's non-compliance is published on national newspapers and on the website of the ACF. Therefore, likewise the ABF, the ACF, despite its name, is not an arbitration and should be compared to an ombusman. The ACF shall publish a report of its annual activity.

4.1.5. The 'solidarity fund' and special-purpose arbitration

A) Competence, tasks and powers

In 2016 the Italian Government introduced two special mechanisms (a solidarity fund and a special-purpose arbitration) to provide redress to the retail clients of four Italian less significant credit institutions (Banca Marche, Banca Popolare dell'Etruria e del Lazio, Cassa di Risparmio di Ferrara, CariChieti) put into resolution and, afterwards, into liquidation.[507] The resolution plan involved the full write down of shares and subordinated debt and the transfer of assets and liabilities to four bridge banks, subsequently authorized by the ECB as credit institutions, and the transfer of bad loans to an asset management vehicle.

To compensate the investors subject to the full write down of financial instruments, the government established a solidarity fund,[508] which is tasked for tasked with granting 'automatic' compensation up to EUR 100 million for eligible clients, under the responsibility and management of the Interbank Deposit Protection Fund.[509] Access to

[507] The four banks were put into resolution with the decision of Banca d'Italia, approved by the Ministry of Economy and Finance, since the 22 November 2015, 22.00. See for more information, the Banca d'Italia notification to the EBA in accordance with Article 83 of the BRRD. See: (https://www.eba.europa.eu/documents/10180/1380023/Notification+from+the+Bank+of+Italy.pdf

[508] The solidary fund was established by Article 1, comma 855 of the Law 208/2015 (Legge di stabilità per il 2016).

[509] The decreto legge n. 59 del 3 maggio 2016, convertito in legge il 30 giugno 2016 (L. 119/2016), conferred on the Interbank Deposit Protection Fund, which is a private-law consortium established in 1987 on a voluntary basis, and is a deposit guarantee scheme to which all Italian Banks participate that is supervised by Banca d'Italia (Article 96-ter of the Legislative Decree 385/1993).

the 'solidarity fund' is restricted to clients that are natural persons or carry out individual businesses, and bought subordinated debt from the four liquidated banks by 12 June 2014. If the client meets certain personal conditions related to his or her income and movable assets,[510] the fund grants a lump sum amounting to the 80% of the purchase price of the subordinated debt.

Alternatively, the client can submit an application for the special-purpose arbitration body (and recourse to this arbitration precludes access to the solidarity fund).[511] Unlike access to the fund, access to arbitration is also possible for clients who purchased subordinated debt after 12 June 2014 and the client can be awarded 100% of the purchase price of the securities. However, the compensation is subject to a determination of the bank liability for the breach of conduct of business rules of information, fairness and transparency laid down by the legislative decree 58/1998.[512] The members of the arbitration bodies shall be appointed by the government, after hearing parliament's commissions, among persons of impartiality, independence and competence.[513]

4.2. Spain

4.2.1. Institutional framework

In Spain out-of-court resolution of financial and banking disputes is based on several different public and private mechanisms. The financial firms have the legislative duty to set up their (private) internal complaints handling (*departamentos o servicios de atención al cliente y el defensor del cliente*). The supervisory authorities have established their own ADR schemes for retail client complaints (*Servicio Reclamaciones* in the Banco de España and CNMV) and arbitration for consumer disputes (*Systema*

[510] The client must prove that his or her personal income in 2014 was lower than EUR 35,000 or that his or her movable assets amounted to less than EUR 100,000 as of 31 December 2015.
[511] Art. 1, commi da 857 a 860, della Legge di stabilità per il 2016 (art. 9, comma 6).
[512] The Law 208/2015 (comma 855).
[513] The decrees establishing the procedural rules and functioning of the arbitration have yet (at time of writing) to be adopted by the government.

arbitral de consumo). In the wake of the financial crisis, a special-purpose arbitration was established to compensate retail clients for losses suffered as a result of the mis-selling of *partecipationes preferentes* and other hybrid financial instruments. The system of ADR in Spain also includes voluntary mediation for civil and commercial disputes, introduced in 2012 to transpose the Directive (2008/52/EC).[514] However, unlike mandatory Italian mediation, the prior attempt of medition is not a condition for the admissibility of the claim in court and does not cover consumer disputes. [515]

4.2.2. Departamento o servicio de atención al cliente and Defensor del Cliente

A) Competence, tasks and powers

Since 1989, credit, investment and insurance firms have had the duty to set up internal complaint handling mechanism to deal with disputes arising between them and their clients.[516] The Law 44/2002 required credit and investment firms to establish a *departamento o servicio de atención al cliente* and/or an indepedent expert to resolve retail client disputes (*Defensor del Cliente*). The members of these ADRs shall be appointed by the firm's management body, among persons of proved experience in the financial and legal sector, and their names shall be communicated to the competent supervisory authority, which shall also approve the rules governing the procedure before these two bodies.[517]

The decision of the *Defensor del Cliente*, unlike those of the *Departamentos de atención al cliente*, are binding on the firm but do not prejudice the right of the client to bring proceedings before courts or other ADR mechanisms. The *Departamentos* and the

[514] Real Decreto-Ley 5/2012, 5 March de mediación en asuntos civiles y mercantiles (BOE n. 162, 5/2012).
[515] See M. L. Villamarin Lopez. 'Mediation in Spain: Dealing with its First National Regulation' in K. J. Hopt and F. Steffek (eds.). Mediation: Principles and Regulation in Comparative Perspective, p. 840.
[516] The Ministry of Finance introduced with the order of 12 december 1989 an internal complaint handling which has been further regulated by the Circular del Banco de España 8/1990, of 7 september. (Article 29 (1) Ley 44/2002, de 22 de noviembre, de Medidas de Reforma del Sistema Financiero (BOE, n. 281 de 23 de 1 de Noviembre 2002)
[517] Ministerio de Economía. ORDEN ECO/734/2004, de 11 de marzo (BOE-A-2004-5290).

Defensor can decide cases up to EUR 60,000 and must decide the case within 60 days. The application to the *Departamentos* or *Defensor* is conditional on having previously brought the case in front of the Complaints Service of the banking, financial or insurance authority (*Servicios de Reclamaciones*). In order to ensure transparency, these ADR bodies must issue an annual report to the board of their bank/firm which shall define into detail the activity carried out over the year.

4.3.1 Servicio Reclamaciones of the CNMV

A) Competence, tasks and powers

The Law 44/2002 established three ADR schemes in the Banco de España, the CNMV and the Directorate General Insurance and Pension Funds to protect clients and investors (*Comisionado para la Defensa del Cliente*).[518] The *Comisionados* were never appointed by the Ministry of Economy and in 2011 they were replaced by the *Servicios de Reclamaciones.* [519]

The *Servicios de reclamaciones* are part of the supervisory department competent regarding the protection of consumers of the three supervisory authorities.[520] In 2013, the Banco de España created a new department, the *Departamento de Conducta de Mercado y Reclamaciones* (DCMR), which merged the former *Servicio de Reclamaciones* and the *División de Relaciones con la Clientela Bancaria* in order to address more effectively the increasing number of complaints concerning the unfair terms in mortgage contracts (i.e. floor clauses).[521] Retail clients, both natural or legal persons, can submit, online or offline, enquiries (*quejas*), complaints (*reclamaciones*),

[518] See the Article 30 (4) of the Ley 44/2002, de 22 de noviembre Rules of procedure laid down by Real Decreto 303/2004.
[519] See the fifth transitional provision of the Ley 2/2011, de 4 de marzo, de Economía Sostenible (BOE n. 55 de 5 de Marzo de 2011).
[520] Ministerio de Economía y Competitividad.Orden ECC/2502/2012 lays down the rules governing the procedures before the Servicios de reclamaciones (BOE-A-2012-14363).
[521] See Banco de España. Servicio de reclamaciones. Annual report 2013, 17.

consultations (*consultas*) in relation to a legal interest or subjective right based on contract terms, financial regulation and good financial practices (*buenas prácticas*).[522] In order to be admissible, complaints must have already been submitted to the firms' internal complaints handling department and must be submitted no later than 6 years since the time the alleged breach occurred. Since 2012, clients can submit multiple complaints through a single action when the firm's conduct is identical or substantially similar.[523] The procedure lasts four months is free of charge for the client.

The *Servicios de reclamaciones* resolve disputes through a non-binding recommendation (*informe*) that must be motivated and must contain a clear statement on whether the financial firm respected the relevant conduct of business rules. [524] It is important to note that the recommendation does not award any compensation or other civil law remedy (avoidance of contract) to the client. [525] When the recommendation is favourable to the complainant, the firm is requested to provide information within one month regarding the follow-up remedial actions taken (e.g. compensation).[526] A firm's failure to respect the recommendation can be taken into account by the authorities in their day-to-day supervision.[527] The decisions of the *Servicios de reclamaciones* are not public but the Banco de España and CNMV issue an annual report that contains the aggregate data on the functioning of these ADRs and the extracts of the most important decisions.

B) Patterns of disputes and adjudicative approach

[522] For the definition of *quejas*, *reclamaciones* and *consultas,* see Article 1(3) of the Real Decreto 303/2004.
[523] Orden ECC/2502/2012, de 16 de noviembre and CNMV Circular 7/2013 of 25 September 2013 (norma octava).
[524] See Servicio de reclamaciones CNMV. Attention to the Complaints and Enquiries of Investors. Annual Report 2011, 28.
[525] CNMV. Memoria reclamaciones 2011, p. 17.
[526] Ministerio de Economía y Competitividad. Orden ECC/2502/2012 and CNMV Circular 7/2013 of 25 September 2013 (BOE n. 262 de 1 de Noviembre de 2013
[527] Banco de España. Memoria de reclamaciones 2015, p. 35.

Disputes before the CNMV focus on the breach of suitability and appropriateness rules with regard to the distribution of hybrid financial products (e.g. PPRs), Lehamn Brothers products, and interest rate swaps. The Annual Report 2015 shows a sharp decline in complaints regarding *PPRs* and other hybrid financial instruments, which in 2013 amounted to 5,790 (94.3%) but only 657 (50.4%) in 2015.[528] Second, while there is a trend of failling complaints for breach of conduct of business rules (there were 41.5% fewer complaints in 2015 compared to 2014), there is a recent litigation trend regarding breach of prospectus rules in the issuance of share capital.[529]

Regarding the appropriateness rule, the CNMV focuses its assessment on whether the responses the clients gave to the firm in the MiFID questionnaires matched the conclusions entities reached on the basis of this information. In this respect, it was recommended that the warnings given to clients as to the lack of appropriateness should be clearly visible and introduced in separate documents.[530] Likewise, the CNMV recommended firms that conclude that a financial instrument is not appropriate for client to inform clients accordingly in a brief document setting out the product's main risks in clear, concise and understandable terms.[531] The CNMV also went so far as to issue a catalogue of recommendations on when a financial product should be considered appropriate (e.g. when the client has actual investment experience in products with similar characteristics, an academic qualification in finance, or when a finance department or chief financial officer is making investment decisions on his or her behalf).[532]

With regard to the suitability rule, the CNMV recommended firms to determine the client's risk profile on the basis of its internal product governance rules and to make sure that this classification is consistent with the client's profile emerging from the

[528] CNMV, Memoria reclamaciones 2015, p. 23.
[529] CNMV, Memoria reclamaciones 2015, p. 26.
[530] CNMV, Memoria reclamaciones 2011, p. 26.
[531] CNMV, Memoria reclamaciones 2012, p. 29.
[532] CNMV, Memoria reclamaciones, 2010, p. 24.

MiFID questionnaire as well as the advice or portfolio management contract.[533] The CNMV stressed in numerous recommendations that it is not good practice for firms to include generic disclaimers in the contractual documentation as evidence of compliance with informational requirements.[534] The CNMV also found that firms provided implicit advisory service despite the lack of an express contractual agreement. The CNMV concluded that, even if Spanish contract law does not require that the advice is subject to a written agreement, firms should provide written documentation when giving advice to clients, irrespective of the 'name' of the service and of whether is given occasionally or on ongoing basis.[535] Similarly, with regard to portfolio management, the CNMV stressed that firms must conclude a written agreement specifying the risk profile of their future investments and stated that the firm's practice of undertaking higher risk policies than those laid down in that agreement is unlawful.

With regard to Lehman Brothers products, the CNMV noted that contractual documentation included contradictory statements whereby the client declared that he or she had been advised on the risks and their investment profile has been assessed, but in other sections claimed that the client had assessed the risk for themselves.[536] A high number of complaints concerned the lack of information regardig the termination costs of interest rate swaps. The CNMV has constantly reiterated that this is key-information that ought to be specified in written form before the conclusion of the contract.[537] With regard to *partecipationes preferentes*, the CNMV reiterated in various recommendations that financial firms should warn client about the high risk related to the liquidation of these instruments. More recently, in numerous decisions the CNMV noted that the firms did not provide adequate information, as prescribed by the CNMV

[533] CNMV, Memoria reclamaciones 2010, p. 26. The CNMV also noted that firms provide wrong classification of investment products, such as the classification of subordinated debt securities in the *'risk free'* bracket (CNMV, Memoria reclamaciones 2012, p. 29).
[534] See in particular CNMV, Memoria reclamaciones 2013, p. 38 where the CNMV laid down recurrent types of terms which should not be included in financial contracts.
[535] CNMV, Memoria reclamaciones 2011, p. 26.
[536] CNMV. Memoria reclamaciones 2010, p. 41.
[537] CNMV. Memoria reclamaciones 2011, p. 27.

Circular 3/2013 in accordance with Article 79bis (7) of the Ley del Mercado de Valores ("LMV"), on the complexity of financial products either because the information was contradictory, and thus mis-leading for the client, or because key-information on the technical features of the product were missing.[538]

The examined data show that the CNMV's ADR performs a role that is much more similar to that of a traditional conduct supervisor rather than that of an adjudication body. This ADR does not take into account principles of national private law and case law nor it adjudicates disputes. Rather, it issues recommendations, based on the financial regulatory framwork, which set down the expectation of the supervisory authority in relation to a concrete situation.

4.3.2. The Departamento de Conducta de Mercado y Reclamaciones ("DCMR")

A) Patterns of disputes and adjudicative approach

The disputes before the DCMR focus on banking contracts and services. In 2015, 20,262 complaints were submitted (compared with 29,528 in 2014 and 34,645 in 2013). Of these, 46% (compared with 52.5% in 2014 and 53% in 2013) concerned floor clauses in mortgage contracts. The DCMR has shown a stricter adherence to the principles of general contract law than the CNMV's *Servicio de Reclamaciones*.[539] The DCMR's recommendations are expressly based on national contract law and the case law of national courts.

As regards the floor clauses, the complaints are centered on the circumstance that banks did not appropriately inform consumers about the functioning of the floor clause, or that the floor clauses was not drafted in a clear and intellegible manner or that the floor limit was not proportionate. Although the DCMR cannot declare the

[538] CNMV, Memoria reclamaciones 2013, p. 40 and Memoria reclamaciones 2014, p. 47.

[539] Banco de España, Memoria reclamaciones 2007, p. 143 'hemos de recordar que sus criterios valorativos no son inamovibles en el tiempo, ya que deben no solo amoldarse a la propia evolución de los negocios financieros, sino —y principalmente— ajustarse a los pronunciamientos que, sobre la materia que versen, vayan emitiendo nuestros órganos jurisdiccionales.'

unfairness of contract terms nor declare the nullity of contracts,[540] it did hold – by taking into account the substantial transparency criteria – that the bank must inform its client about the interest rate floor (or cap) and the term must be invididually negotiated and specifically approved by the borrower before the conclusion of the loan agreement.[541] However, in 2015 only 35.4% of recommendations were followed by the financial firms (16.4 % in 2014).

The DCMR has also shown strong adherence to the case law of the national courts in other patterns of litigation regarding alleged unfair contract terms. For example, the DCMR decided that that bank shall keep all the contractual documentation for the period established by the civil code or the relevant legislation with the consequence that it is up to the banks to show that the client did know and accept the contractual terms and conditions.[542] In line with case law, the DCMR decided that the net-off clauses are valid if they are written in a clear, plain and intelligible manner that can be fully understood by the client.[543] Instead, the DCMR decided that the rounding-off clause is contrary to good financial practice because it presents a significant prejudice to the consumer, who is forced to go to court or administrative bodies in order to remove the clause from the loan agreement.[544]

Regarding structured deposits, the DCMR held, in line with the case law, that banks should assess the suitability and appropriateness this products for retail clients in order to allow them to take a rational commercial decision and avoid that they may be surprised by unforeseeable events.[545] The Supreme Court has recently underlined, in relation with structured deposits, that banks should adequately inform its customer on

[540] Banco de España, Memoria de reclamaciones 2013, p. 398.
[541] Banco de España, Servicio reclamaciones. Annual report 2012, 115; Annual report 2013, 380 and Memoria reclamaciones 2015, p. 84.
[542] Annual report 2008, 85; Annual report 2011, 195. See the judgments STS sentencias n.o 277/2006, de 24 de marzo, y n.o 1046/2001, de 14 noviembre
[543] Annual report 2011, 74. Annual report 2013, 418. See the judgments in STS,792/2009
[544] Annual report 2012, 112; Annual report 2013, 75. See the judgments in See STS, Sala do Civil, 4.11.2010, 5792/2010; STS, Sala do Civil, 11.2.2015, Recurso: 249/2006.
[545] Banco de España, Memoria de reclamaciones 2011, p. 184 and Memoria de reclamaciones 2015, p. 169.

the risk related to the product in accordance with the duty of good faith and the financial legislation and that in the absence of adequate information the contract could be declared void for mistake.[546]

4.4. Special floor-clauses related redress mechanisms

A) Competence, tasks and powers

It is important to recall that in 2013 the Plenary Session of the Supreme Court, in a dispute between a consumer association and many credit institutions, held that the floor clauses breached the transparency requirement of the Directive 1993/13 because even if they were clear in the text (*transparencia documental*) they did not ensure that the consumer effectively understood the material consequences of their application (*transparencia real*).[547] Therefore, the Tribunal Supremo declared the floor clauses null and void but limited the retroactive effect of the declaration of nullity to avoid serious economic repercussions on the creditors and the financial system.[548] In the Joined Cases C‑ 154/15, C‑ 307/15 and C‑ 308/15, *Francisco Gutiérrez Naranjo et al.,* the CJEU held that this case law is in contrast with Article 6(1) of Directive 93/13. This important judgment triggered some important national 'regulatory' reactions to cope with the expected very high number of claims for restitutions. On 20 January 2017 the Spanish government issued a decree requiring credit institutions a special internal complaint handling mechanism to return the sums they paid to the credit institution as a result of the unfair floor clauses included into mortgage contracts to consumers.[549] After the complaint made by the consumer, the banks shall make a

[546] STS, Pleno, Sala de lo Civil, Madrid, núm. 460/2014, del 10 de septiembre de 2014, recurso: 2162/2011. See also STS, Sala do civil, pleno núm. 840/2013, de 20 de enero de 2014.
[547] STS, 9 May 2013, n. 241, in particular, paragraph 211. See also STS, 8 September 2015, n. 464/2014; STS, 25 March 2015, n 139 and 23 December 2015, n. 705.
[548] Joined Cases C‑154/15, C‑307/15 and C‑308/15, Francisco Gutiérrez Naranjo et al., ECLI:EU:C:2016:980. See for more details Chapter 8, below.
[549] Real Decreto-ley 1/2017, de 20 de enero, de medidas urgentes de protección de consumidores en materia de cláusulas suelo (BOE n. 18 de 21 de enero de 2017).

proposal for the restitution and the consumer can accept it within 90 days.[550] The acceptance of the proposal, precludes access to courts for the consumer. Moreover, on 25 May 2017, the Spanish General Council of the Judiciary (Consejo General del Poder Judicial) put in place an extraordinary measure consisting of mandating 54 Courts of First Instance (at least one per province) to only deal with floor clauses mortgage contracts.[551]

4.5. The Sistema Arbitral de Consumo

A) Competence, tasks and powers

The *Systema Arbitral de Consumo* was introduced by the Law 26/1984, under the Article 51 of the Spanish Constitution[552] to provide an arbitration scheme for the resolution of consumer disputes. The decision of the arbitrator is legally binding, enforceable and non-appealable.[553] The award can be annulled by national courts only in exeptional circumstances, including any violation of a mandatory rule governing the arbitration.[554]

Apart from this feature, the *Systema Arbitral de Consumo* is characterized by several differences in comparison to the traditional models of arbitration. First, the system is managed by public administrations that appoint the members of the panels, organized at the national and local level. Second, this arbitration can be initiated not only on the basis of an arbitration clause but also by the acceptance of the public offer for

[550] The parties can agree to suspend ongoing proceedings on the same matter to start this extra-judicial process and the judicial proceedings on the same subject-matter can be suspended during the procedure, at the parties request, during this process.
[551] The measure shall be in force from 1 June until 31 December 2017. See http://www.poderjudicial.es/portal/site/cgpj/menuitem.65d2c4456b6ddb628e635fc1dc432ea0/?vgnextoid=3b96a92cf8f3c510VgnVCM1000006f48ac0aRCRD&vgnextlocale=en&vgnextfmt=default&vgnextchannel=a64e3da6cbe0a210VgnVCM100000cb34e20aRCRD&lang_choosen=en
[552] Article 51 requires public bodies (*poderes públicos*) protect consumers and clients through proceedings that ensure their safety, health and legitimate economic interests of consumers. After a short period of experimentation from 1986 until 1993, the arbitration for consumers disputes was formally enacted and disciplined by the RDL 636/1993 and recently modified by the RDL 231/2008.
[553] If the parties agree on the proposal of the arbitrator, the dispute can be settled before the final determination.
[554] See also Case C-168/05, *Mostaza Claro*, ECLI:EU:C:2006:675.

arbitration put forward by the business or by filing the complaint with the arbitration board.[555] Third, its procedure aims to facilitate the consumer's access to justice: legal assistance is not compulsory, the proceeding must terminate within six months (except for motivated reasons) and the arbitrators decide on the basis of equity, unless the parties agree to that the dispute is decide on the basis of law. The procedure is confidential (the hearing is private, and parties and arbitrators can be sanctioned if they reveal the contents of the award) and free of charge for the consumer.

Although this arbitration scheme is competent to resolve financial and banking disputes involving consumers, it has so far played a very limited role in financial dispute resolution. In 2007, only 1.3% of arbitration awards dealt with banking or financial contracts.[556] The main reasons for the scarce use of this ADR can be found in the fact that a developed sectoral system of ADR already exists that is based on both firms' internal complaint mechanisms and the ADR set up by the supervisory authorities. In addition to this, as I will show below, national courts seem to be relatively affordable for consumers and retail investors and have managed to provide a high level of protection through compensatory and restitutionary remedies to clients.

4.6. The special-purpose arbitration for disputes on participationes preferentes and hybrid financial instruments

A) Competence, tasks and powers

After the financial crisis, a special-purpose arbitration scheme was set up to resolve disputes between retail clients and credit institutions owned by the *Fondo de reestructuración ordenada bancaria* (FROB) for the mis-selling of *participationes*

[555] The business, on the other hand, can oppose in cases where the consumer does not comply with the arbitration clause.

[556] DG SANCO. Study on the use of Alternative Dispute Resolution in the European Union – Country report Spain, 2009. Available at http://ec.europa.eu/consumers/redress_cons/sp-country-report-final.pdf.

preferentes and other hybrid financial instruments.[557] To understand the rationale of this ADR, it is worth noting that burden sharing of hybrid capital holders and subordinated debt holders in banks receiving public capital was a requirement of the MoU between Spain and the Euroepan Commission.[558] Accordingly, FROB allocated the banks' losses to these investors and set up the special-purpose arbitration to provide effective, cheap and quick redress to the bailed-in investors and to limit the amount of losses to be ultimately borne by the FROB, namely by 'allocating' on this public-fund only the losses which did not derive from mis-selling practices.[559]

To ensure transparency and accountability of this arbitration procedure, the Real Decreto 6/2013 set up a commission of inquiry (*Comisión de seguimiento de instrumentos híbridos de capital y deuda subordinada*), under senior representatives from the CNMV and the Banco de España. It was in charge of the oversight of this out-of-court mechanism.[560] The arbitration scheme was only available for retail clients holding *participationes preferentes* and other defined complex instruments amonting up to EUR 10,000 (417,490 retail clients were covered to a total amount of EUR 7,940 million).[561] The arbitrators have the competence to decide whether, at the time of purchase, the consent of the client was valid according to the criteria set out by the *Comision de seguimento*.[562] These criteria include both private law-derived factors, such as the lack of capacity to contract, and regulatory-derived factors such as the missing or incorrect information about the product features and risks.

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[557] BFA/Bankia, Catalunya Caixa, NCG Banco and Banco de Valencia. The 18 December 2013 the FROB resolved to sell the total of its participation in NCG Banco S.A. (88, 33 %) to Banco Etcheverría, S.A. /Grupo Banesco del total de su participación.
[558] MoU, para 17.
[559] See CFA Institue. Redress in retail investment markets. International Perspectives and Best Practices. January 2015, p. 47.
[560] See F. Zunzunegui. 'Mis-selling of preferred shares to Spanish retail clients', 174.
[561] Comisiòn de seguimento de instrumentos hybridos de capital y deuda subordinada. Séptimo informe trimestral sobre la comercializaciòn de instrumentos hibridos de capital y deuda subordinada. Enero 2015.
[562] FROB, Publicidad de los criterios básicos determinados por la Comisión de Seguimiento de Instrumentos Híbridos de Capital y Deuda Subordinada. Nota de prensa – Madrid, 17 de abril de 2013. Available on http://www.frob.es/es/Lists/Contenidos/Attachments/319/20130417_PREFERENTES.pdf

The procedure is divided into two phases. In the first, an independent expert appointed by the banks, assesses the merit of each claim and calculates the maximum recoverable compensation.[563] The independent expert then issues an opinion that is followed by a proposed covenant to submit the claim to arbitration. If the client accepts the covenant, he or she must sign an 'Arbitration Agreement', waiving the right to pursue the dispute before a court of justice. The second phase of the procedure is thus managed by the systema arbitral de consumo which decided the dispute through a legally-binding and enforceable award. The arbitration was in law and not in equity and the opinion of the expert served to support evidence.[564] The awards are not publicly available and it is therefore not possible to fully understand the impact of private law and case law on this procedure. However, on the basis of the criteria mentioned above, it seems that both contract law and regulatory criteria played a role in the adjudication.

B) Patterns of disputes and adjudicative approach

According to the most recent data published by the *Comision de seguimento* (January 2015), 79% of eligible clients (328,059) submitted an application for arbitration, the total amount being EUR 5,188 billion (65% of the total).[565] The independent expert issued a positive opinion in 75% of cases. Among them, 73% (282,414 clients) received a favourable arbitration award with the total amount being almost EUR 3 billion (EUR 2,988 million). Therefore, each arbitration award has on average provided EUR 10,580 in compensation.

To have a better understanding of the impact of this arbitration scheme on financial disputes in Spain, it is importat to contrast these figures with those related to judicial disputes. Over the same period of time, 29,461 lawsuits were filed with national courts

[563] PWC for Nova Galicia Banco, Ernst & Young, for Catalunya Banc and KPMG for Bankia.
[564] See CFA institute. *Redress in retail investment markets*, p. 51.
[565] Comision de seguimento de instrumentos híbridos de capital y deuda subordinada. Séptimo informe trimestral.

totalling almost EUR 1,830 billion.[566] As of January 2015, the first instance courts had ruled in favour of clients in 89.4% of cases and had awarded EUR 530 million in compensation. The average award per judgment was thus EUR 60,000.[567]

Taken together, these data clearly show that litigation has delivered much better outcomes than arbitration, in terms of compensation, to retail clients.[568] As I will show below, this good outcome for client protection is primarily the result of judicial interpretation of national private law in light of the purpose of EU-driven financial regulation.[569] However, since this pro-investor case law transfers money from the publicly-owned FROB (and not from the banks) to clients, the deterrence-effect of these judgments could be limited. In the final instance it is the public finances that pay, both in cases of arbitration and litigation.

4.3. France

4.3.1. Institutional framework

In 2001 the *Loi Murcef* introduced a duty for credit institutions to set up an internal mediation scheme to settle disputes arising with retail clients and to inform clients about this redress scheme.[570] The credit institutions have since established internal mediation schemes (*médiation en compte propre*), like the *Médiateur auprès de BNP Paribas pour la clientèle des particuliers*, or have adhered to schemes provided by trade associations, such as the *Fédération bancaire française* (FBF) and the *Association des Sociétés Financières* (ASF) (*médiation en compte commun*).[571] Besides these ADR

[566] This data includes the disputes against Bankia, Catalunia caxia and NGC Banco.
[567] Spanish courts handed down 8.717 judgments in favour of clients and 1.043 judgments in favour of credit institutions.
[568] It must be reminded, however, that these data consider first instance judgments that could be subject to appeal.
[569] See Chapter 4, below.
[570] Law n° 2001-1168 du 11 décembre 2001 (*Loi Murcef*).
[571] The *Médiateur de la Fédération Française des Sociétés d'assurances (FFSA)* and the *Médiateur de Groupement des enterprises mutuelles d'assurances (GEMA*) are competent for the resolution of insurance-related disputes. The *Médiation du crédit aux entreprises* is responsible for the mediation of

schemes for the resolution of firm–client disputes, the *Médiation de crédit* is responsible for the resolution of disputes between credit institutions and entrepreneurs related to the granting of loans and other funding to enterprises, in particular, in case of insolvency of the entreprise.[572]

Whilst in the banking sector ADR are privately run and funded, in the financial sector, since 2003 the system of out-of-court dispute resolution has been based on a single, publicly run and funded mediation scheme established in the AMF (*Médiation de l'Autorité des Marchés Financiers*).[573] Some of these mediation schemes (*e.g. Médiateur AMF, Médiation* ASF and *Mediation BNP Paribas*) participate in the *Club des Médiateurs du Service Public*, a private association set up in 2002, which represents the mediation schemes operating in different sectors of the economy (financial services, telecomes, post, transport) and lays down a uniform rules of conduct and procedures.[574]

In 2015, the new rules transposing the ADR Directive in the French legal system, conferred on the consumer the right to have access to a mediation scheme to resolve a dispute with a credit institution or payment service provider[575] and established the *Commission d'évaluation et de contrôle de la médiation* to keep a list of consumer mediations schemes which shall be notified to the European Commission.[576]

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disputes between credit institutions and professionals or enterprises for disputes arising in relation to loans granting policies.

[572] The mediation scheme is based upon the agreement signed the 27 July 2009 between the Ministry of Economy and Finance, Bank of France, the FBF, the ASF, the IEDOM and the IEOM. On 28 April 2014, this scheme was extended until 21 December 2017. This mediation comprises a *médiateur national*, appointed by the President of Republic, and *médiateurs territoriaux*, managed by directors of the Bank of France. The mediator must help (*orienter*) the complainant to sue the commercial tribunal if the enterprise does not manage to fulfil its payment obligations. If the tribunal opens an insolvency proceeding, the mediation can continue on the request of the mandataire social (liquidator).

[573] Law n° 2003-706 du 1er août 2003 de sécurité financière. This law created the *Comité consultatif du secteur financier* within the Ministry of Finance with the aim representing the interests of financial firms and clients and to monitor the regulatory, supervisory and ADR developments of French financial markets.

[574] The regulation (*charte du club*) was adopted in 2004 and amended in 2011.

[575] Article L316-1 of the CMF. The mediation shall be regulated by the code of consommation (Article Article L611-1 ss) as amended by the Ordonnance n° 2016-301 du 14 mars 2016 relative à la partie législative du code de la consommation.

[576] The *Commission d'évaluation et de contrôle de la médiation* replaces the *Comité de la médiation bancaire* introduced by the *Loi Murcef*. See Ordonnance n° 2015-1033 du 20 août 2015 relative au

4.3.2. The AMF mediation

A) Competence, tasks and powers

The mediation procedure of the AMF is based on Article 621-19 of the CMF and the *charte de mediation*.[577] The mediator is appointed by the President of the AMF for a three years-term and shall respect requirements of independence. The mediator cannot receive instructions regarding the resolution of disputes and dispose of its own budget. The mediator is competent for the resolution of disputes related to the breach of conduct of business rules for financial services, irrespective of their value. Both retail and non-retail investors are eligible to submit a complaint to the AMF.[578] In order to be admissible, the client must have already complained with the firm's internal complaints handling body and must not have submitted any complaint to courts. Clearly, differently from the ombudsman scheme, the mediator can consider the case only if both parties agree to initiate the mediation procedure.

The mediation procedure shall last 90 days and is concluded by a non-binding proposal (*avis*, *proposition de règlement amiable* o *recommandation*) to the parties. The parties have 30 days to accept or refuse this proposal and they can also mandate the AMF mediator to monitor the execution and enforcement of the mediation agreement. Recourse to mediation suspends the prescription period. The mediation procedure is subject to strict confidentiality rules. Statements, opinions and documents used in the course of the mediation procedure cannot be used by the parties during the judicial proceeding; only the mediator's proposal can be presented in court.

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règlement extrajudiciaire des litiges de la consommation and Décret n° 2015-1382 en date du 30 octobre 2015 relatif à la médiation des litiges de la consommation.

[577] The *charte de mediation* was originally drafted in 1997 and subsequently revised after the establishment of the AMF.

[578] AMF, Annual report 2014, 10.

Within the mediation mandate, the AMF has also the power to submit proposals for legislative reforms related to the protection of consumers and clients of financial services. This provides for a strong link between the dispute resolution and supervisory function of the AMF. The AMF publishes an annual report, which contains only the aggregate data on the functioning of the ADR, and must be delivered to the *Collège de l'Autorité des marchés financiers*, the President of the Republic and the parliament.

B) Patterns of disputes and adjudicative approach

Since 2013 there is a constant increase of complaints submitted to the AMF mediation (907 in 2013, 1.407 in 2015). In 2015 the 62% of proposals were favourable to the clients and in the 93% of the proposals the financial firm followed and implemented the proposal. The main patterns of litigation concern the execution of orders, the breach of appropriateness and suitability rules and the portfolio managemetn rules with regard to complex financial products. In 2015 there was an increase in complaints about breach of conduct of business rules concerning investments on Forex markets (228 complaints received, 62 % more than 2014).[579] On average, proposed mediation related to Forex disputes range between EUR 200 and EUR 52,700, with a total amount of EUR 379,209. Since mediation proposals are not publicly available, it is not possible to fully understand the adjudicative approach to this mediation. However, the aggregate data on the functioning of this ADR show that the number of complaints submitted and the strong link with the AMF suggests that the mediation follows the supervisory approach and acts of the AMF, and thus effectively contributes to the achievement of the client protection objective of the AMF.[580]

[579] AMF Mediation, Annual report 2015, 19.
[580] See AMF, *Rapport du médiateur*, 2008, 2.

4.3.3. Médiation de Fédération bancaire française (FBF) and Médiation de l'Association française des Société Financières (ASF)

A) Competence, tasks and powers

This mediation schemes offered by the FBF and the ASF are available to consumers and firms that adhere to the association.[581] The two mediation schemes are governed by similar rules of procedure.[582] The mediator of the FBF is appointed by its executive committee but it is operationally and functionally independent from the association.[583] The ASF mediator is appointed by the executive committee after hearing consumer associations.[584]

The ASF and FBF mediators have a broad competence that includes disputes regarding financial services as well as banking services and certain insurance services. Unlike the AMF one, these mediations are available only for consumers (natural persons who act outside their trade, business or profession). The ASF mediation is competent also for disputes related to the application and enforcement of a over-indebtedness plan, the amicable recovery of a consumer credit under certain conditions and the disputes concerning the European agreement on a voluntary code of conduct on pre-contractual information for home loan adopted on the basis of Commission's guidelines.[585]

The procedure, which is free of charge for the consumer, shall last 90 days and suspends the prescription period and does not prejudice the right of the parties to pursue the claim in court. The mediator's proposal is not legally binding but the

[581] 80 investment firms adhere to the ASF mediation and 225 credit institutions adhere to the FBF mediation.
[582] See *charte de la mediation* FBF and *charte de mediation* ASF.
[583] The mediator is paid by the SDTB, a subsidiary (*filiale*) of the FBF.
[584] Charte de la mediation ASF (art. 2). There is no express requirement of independence for this mediator.
[585] See Commission. Recommendation of 1 March 2001 on pre-contractual information to be given to consumers by lenders offering home loans (notified under document number C(2001) 477).

mediator can order the publication of the proposal in the contract between the firm and the client. The FBF's rules of procedure specify that the bank cannot use banking secrecy at any stage of the procedure and that the mediator must take its determination on the basis of law and/or equity.[586] In order to personalise the decision, he or she shall 'systematically' require to the bank data related to the investor's profile. The final determination is a non-legally binding recommendation. That siad, if the bank does not intend to comply it must explain to the association the reasons for th non-compliance ('comply or explain').[587] The FSB and ASF publish an annual report with the aggregate data of their activity (mediation proposals or their extracts are not publicly available)[588] and the ASF provides also that the decision of the mediator must be published on the website and must be mentioned in the contract between the bank and the complainant.[589]

B) Patterns of disputes and adjudicative approach

In 2015 the ASF mediator received 1,783 complaints (compared with 1,755 in 2014). The overwhelming majority of complaints concern insurance and banking services, including disputes on the early repayment of consumer loans and restructuing of consumer's debt ; only 5% of complaints concerns financial services. In 2015 the mediator has given a favourable recommendation (proposal) to the client in 495 out of 1.009 complaints (at p. 6 of annual report 2015, figures of number of complaints). In 2015 the FBF mediation received 4,182 complaints (up from 2,984 in 2014).[590] Some 80% of complaints concerned banking services (payments, consumer credit and mortages), whereas the remaining complaints included insurance and financial services. The mediator ruled in favour of the client in 564 proposals out of 785.

[586] Charte du service de médiation auprès de la fédération bancaire francaise (art. 1). Available at www.fbf.fr
[587] Charte mediation ASF (art. 6).
[588] Charte de la mediation FBF (art. 7) and Charte de la mediation ASF (art. 9).
[589] Charte de la mediation FBF (art. 8) and Charte de la mediation ASF (art. 8).
[590] FBF mediation. Annual report 2015, 15.

4.3.4. The mediation of banking groups (médiation en compte propre)

A) Competence, tasks and powers

The largest French banking groups (BNP Paribas, Credit Agricole and Société Générale) did not adhere to the FBF or ASF but established their own 'in-house' mediation schemes (*médiation en compte propre*). Their rules of procedure (*chartes de mediation*) generally follow those of the FBF but lay down stricter requirements in relation to the material scope of application and access to the ADR. These mediation schemes are competent for all the disputes concerning banking, financial and insurance services provided for by the firm (group's entities). Access to the procedure, however, is restrcited to consumers (natural persons who act outside their trade, business or profession). The parties to the procedure must respect a duty of confidentiality and must not disclose information related to the procedure in the course of subsequent judicial proceedings, unless expressly agreed. The client's recourse to mediation, however, is considered as an express authorization to waive bank secrecy with regard to the information necessary for the mediation investigation.

Significantly, the mediation rules of procedure of these banking groups expressly provide that the disputes related to the policy of the bank (*politique générale*) – including tarifs and refusal of credit – and those related to the performance of financial instruments dependent upon market oscillations fall outside the scope of their mediation.[591] This is likely to significantly reduce the number of admissible complaints. Moreover, the rules of procedure introduce some important restrictions to the complainant's access to the ADR. First, if a judicial proceeding has already been

[591] Charte de la mediation BNB Paribas. Clientele des particuliers, Juin 2014, art. 1. Available at https://www.secure.bnpparibas.net/banque/PA_CanalnetApp/documentum/canalnet/public/PDF/Charte_Mediation_Bancaire_BNP_Paribas_20080523034436.pdf; Charte de la mediation bancaire du credit agricole (31 décembre 2013) art. 3-2. Available at https://www.ca-paris.fr/charte-mediation.html; Charte de la médiation. Société Générale, art. 3. Available at https://static.societegenerale.fr/ass/ASS/Repertoire_par_type_de_contenus/Fichiers_a_telecharger/charte-mediation.pdf.

initiated, the acceptance of the mediation by the mediator determines the suspension of the judicial proceeding until the end of the mediation procedure.[592] But inasmuch as mediation suspends any court action seeking an order for payment or resolution of a contract that interrupts any execution path, the recourse to the mediation does not preclude the bank from adopting precautionary measures (*mesures conservatoires*).[593] Finally, the rules of procedure expressly provide that the parties can at any time settle the dispute through a legally-binding agreement (*transaction*) under French civil law (art. 2044 c.c.). This agreement shall be confidential and precludes access to court for the parties.

The mediation is free of charge for the consumer and shall last 90 days. It is concluded by the meditor's proposal, which is non-legally binding on the parties. However, unlike the other examined mediation schemes, the rules of procedure give the parties the power to transpose the proposal into a legally-binding settlement agreement (*transaction*) that has the effect of preventing the parties from pursuing the claim in court.[594] The annual report includes aggregate data on mediation (but not mediation proposals) and shall be published on the firm's website. In 2014, 2,058 clients submitted a complaint for mediation (compared with 2,023 clients in 2013) and 86% of complaints concerned consumer credit-related issues (the remaining complaints dealt with mortgage loans and payment services).[595] Some 72% of the mediator's proposals were favourable to the clients.

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[592] Charte de la mediation bancaire du credit agricole (art. 8); Charte de la médiation. Société Générale (art. 9). The BNP Paribas mediation scheme, by contrast, provides that mediation cannot be initiated if a judicial proceeding is ongoing (art. 5).

[593] Charte de la mediation BNB Paribas (art. 8); Charte de la mediation bancaire du credit agricole (art. 8); Charte de la médiation. Société Générale (art. 9). Precautionary measures seem to refer to judicial actions aimed at preserving the credit before the declaratory action. See also the Recommandation 2013-01du Comité de la médiation bancaire du 30 avril 2013 relative aux chartes, contrats et documents assimilés portant application des dispositions légales régissant la médiation bancaire (art. 3).

[594] Charte de la mediation BNB Paribas (art. 3); Charte de la mediation bancaire du credit agricole (art. 9).

[595] BNP Paribas, Mediation annual report 2014, p. 7.

4.4. The UK

4.4.1. Institutional framework

The system of out-of-court dispute resolution in the UK is centred on the Financial Ombudsman Service (FOS).[596] This ADR, which was established by the FSMA in 2000, replaced eight dispute resolution schemes in the financial sector organized either on a voluntary or a regulatory basis.[597] The FOS's main objective is to resolve disputes between firms and clients 'quickly and with minimum formality.'[598] Besides the FOS, the out-of-court financial dispute resolution is based on private organizations which offer mediation, arbitration and conciliation schemes.[599]

4.4.2. The Financial Ombudsman Service ("FOS" or "the Ombudsman")

A) Governance

The FOS is administered by a body corporate acting as scheme operator (the Financial Ombudsman Service Limited) and is composed of a chair and nine directors (the board) appointed by the FCA and funded by industry. The scheme operator is responsible for appointing the ombudsmen and the Chief Ombudsman.[600]
Even though the FOS is operationally independent from the FCA,[601] the latter maintains relevant powers with regard to the governance of the former (e.g. appointment and removal of directors of the scheme operator). Moreover, the FSMA

[596] The FOS is regulated by Part XVI and Schedule 17 of the FSMA 2000 (Sections 225-234) and by the redress part (DISP) of the FCA Handbook.
[597] The Office of the Banking Ombudsman ('OBO'), the Office of the Building Societies Ombudsman ('OBSO'), the Office of the Investment Ombudsman ('OIO'—for firms regulated by IMRO), the Insurance Ombudsman ('IOB'), the Personal Insurance Arbitration Service ('PIAS'), the PIA Ombudsman Bureau ('PIAOB'), the SFA Complaints Bureau and Arbitration Service ('SFA CB') and the (voluntary) FSA Direct Regulation Unit and Independent Investigator.
[598] Section 225 of the FSMA 2000.
[599] See in particular the City Disputes Panel (CDP) is non-profit organisation created in 1994 with the purpose of resolving disputes in the financial service industry through several ADR procedures to market participants.
[600] See schedule 17 ('the Ombudsman scheme') FSMA 2000.
[601] See s. 1B and 225 FSMA 2000; MoU between FSA and FOS, April 2007; MoU between FCA and FOS, April 2007 and 2013.

2000 requires the two authorities to cooperate and collaborate to achieve their regulatory objectives on the basis of a Memorandum of Understanding (MoU).[602] The last MoU, signed on 18 December 2015, lays down the general principle of the division of independence and division of responsibilities between the FCA and FOS and requires the two authorities to cooperate and share information regarding the fulfillment of their tasks. In particular, the MoU implements the duty, introduced by the FSA 2012, to disclose to the FCA any information that 'would or might be of assistance to the FCA in advancing one or more of the FCA's operational objectives' (s. 232A). In addition to this, it requires the FOS to inform the FCA about serious shortcomings in a firm's complaint handling, concerns about the fitness and propriety of a firm or approved person; or other issues that may require action by the FCA in accordance with its statutory objectives. The 'external' independence of the FOS is guaranteed by a limited immunity from liability in damages. The FOS can be held liable only if the act or omission is shown to have been in bad faith; or so as to prevent an award of damages made in respect of an act or omission on the ground that the act or omission was unlawful as a result of section 6(1) of the Human Rights Act 1998.[603]

B) Jurisdiction and procedure

The FOS jurisdiction is divided into compulsory and voluntary. The compulsory jurisdiction covers any act or omission made by regulated firms in carrying out their regulated activity. The FSA 2012 has extended the scope of the compulsory jursidiction to include consumer credit jurisdiction, introduced by the Consumer Credit Act 2006 (s. 227A FSMA 2000) and jurisdiction over complaints from a complainant who is not satisfied with a redress determination made by a respondent under a consumer redress scheme. The voluntary jurisdiction applies only to those firms (so-called 'VJ

[602] See under the FCA' s regime the MoUs of 1 April 2013 and of 18 December 2015. Under the FSA regime, MoU between the Financial Services Authority and the Financial Ombudsman Service Limited (the FOS) (last updated 6 April 2007), at http://www.fsa.gov.uk/pubs/mou/fsafos.pdf. See also the MoU between the FOS and theInformation Commissionr's office, OFT, Pensions Ombudsman, Banking Code Standard Board.
[603] See Section 225(4) of the FSMA 2000 and Sch.17, para. 10.

participants') that voluntarily join the scheme and comprises every complaint that is not covered by the compulsory jurisdiction, in particular, complaints against unauthorized firms.[604] The voluntary jursdiction is subject to the same procedural rules of the compulsory jurisdiction, unless otherwise established, and the Ombudsman has the same powers to make determinations and awards under the Voluntary Jurisdiction as he or she has under the Compulsory Jurisdiction (DISP 4.2.4).[605]

The FOS resolves *complaints* at the earliest possible stage and by whatever means are deemed most appropriate, including mediation or investigation.[606] The FOS has the power to start investigations and ask information of the parties and can invite them for a hearing.[607] The procedure is free of charge and complaints do not need to be assisted by a lawyer in order to bring complaints to the FOS.[608]

A complaint is admissible only if it is brought by qualified persons, such as, in particular, a consumer, or a micro-enterprise with assets of less that £1 million (professional clients and eligible counterparty cannot are not entitled to complain).[609] In addition to this, the complainant must have already submitted its complaint to the firm's internal complaint handling, the complainant must comply with strict time-limits.[610]

If these procedural conditions are met, the FOS can decide to uphold or dismiss the complaint on the substance or to dismiss the complaint without examining the substance for a number of "subjective" (e.g. the complainant has not suffered (or is

[604] See Jackson and Powell on Professional Liability, 8th Edition, London: Sweet and Maxwell, 2016, p. 1071.

[605] DISP 4.2.4.

[606] The FOS has wide discretionary powers in respect to how to conduct mediation and investigation and which decisions to adopt in these phases, including, the power to require the parties specific information, documents (s. 231 FSMA 2000) or evidence (DISP 3.5.11). Failure to comply with the request can be dealt with by the court. (s. 232 FSMA 2000; DISP 3.5.11).

[607] DISP 3.5.7. In deciding whether there should be a hearing and, if so, whether it should be in public or private, the *Ombudsman* will have regard to the provisions of the European Convention on Human Rights.

[608] DISP 3.7.10.

[609] See DISP 2.7.3 and DISP 2.7.9.

[610] The conditions of admissibility are laid down in DISP 2.8.2.

unlikely to suffer) financial loss) and "objective" (e.g. the complaint is frivolous or vexatious or it has already been considered by courts) grounds.[611]

The 'test case'

In two particular situations, which reflect a move from the traditional dispute resolution function of the FOS to a more innovative quasi-supervisory function,[612] the FOS has the power not to consider the merits (or substance) of the complaints. First, the Ombudsman may – with the complainant's consent – deem the case be referred to the court as a 'test case'.[613] The 'test case' procedure can be initiated if the FOS decides that the dispute raises an important or novel point of law and would more suitably be dealt with by a court. However, the use of the 'test case' procedure has been rare because disputes are generally centred on matters of facts and do not turn on matters of law.[614]

The 'wider implication case' ('WID')

The FOS, the FCA, or an interested party (consumer or industry body) can start a wider implication case ("WIC") when there is an issue that may have 'wider' implications for a relevant number of consumers and firms.[615] In this circumstance, the FCA may decide

[611] See in more detail DISP 3.3.4.
[612] See R. James and P. E. Morris. 'The Financial Ombudsman Service: A Brave New World in Ombudsmary' Public Law (2002): 640. See also FSA-FOS, FSMA, *2 Year Review: Financial Ombudsman Service*, para 3.11. See I. G. MacNeil, *Broad Standards as a Vehicle for Consumers Rights: the Case of Financial Products in the UK*, in M. Kelly-Louw, J. P. Nehf, P. Rott (eds.), The Future of Consumer Credit Regulation: Creative Approaches to Emerging Problems, Ashgate (2008): 46.
[613] DISP 3.4.2.
[614] (FSA, Consultation Paper, 19/2006, 17. A test case was initiated by the PIA's Ombudsman which referred to courts the decision about the Equitable Life's bonus case. The House of Lords, by overturning the judgment of the High Court, decided that the company's directors decision to set differetn criteria of remuneration was contrary to the terms of the policy (*Equitable Life Assurance Society v. Hyman* 2000] 3 All ER 961). Another test case was launched in 2007 by the FOS, in agreement with the OFT before the High Court to tackle the issue of unauthorized overdraft bank charges (http://www.financial-ombudsman.org.uk/news/updates/bank-charges-26-07-07.html) and
[615] The WIC is not based on statutory law or regulation but has been developed as a working practice between the FCA and the FOS. The details of the procedure are set out on the dedicated web pages produced by the FSA and the ombudsman service: http://www.financial-ombudsman.org.uk/publications/ombudsman-news/57/57-wider-implications.htm

to tackle the issue by means of a specific regulatory or supervisory action. If the FCA decides that this solution is not the most appropriate way forward, then the FOS will consider consulting industry and consumer experts before reaching a decision on individual cases or, if the firm agrees to pay the complainant's legal costs, the ombudsman service will consider whether the issue is more suitable for a 'test case' in the courts.

The WIC process has been adopted in the context of mis-selling of Payment Protection Insurance ("PPI") . On 1 July 2008 the FOS's Chairman warned the Chairman of the FSA that the systemic mis-selling of PPI cannot be merely solved by the FOS by means of individual dispute resolution, but needs a 'wider regulatory action' by the FSA. Following a request from the FOS, in 2010 the FSA prepared two consultation papers and then published Policy Statement 10/12, which introduced new rules in the DISP section of the Handbook on the fair assessment and redress of complaints related to sales of PPI and new rules requiring firms to assess complaints taking into account also the relevant decisions of the FOS.[616] The British Bankers' Association challenged the validity of this policy statement, in particular because it introduced new principles imposing obligations for firms leading which are actionable by private investors. In 2011 the High Court dismissed this claim and held that, even if the principles could not be enforced by private law remedies (Section 150(2) of the FSMA), the FOS has the statutory duty to take them into account in deciding what would be fair and reasonable and what redress to afford.[617]

C) Decision

[616] FSA, The assessment and redress of Payment Protection Insurance complaints Feedback on the further consultation in CP10/6 and final Handbook text. See in more detail E. Ferran. 'Regulatory lessons from the payment protection insurance mis-selling scandal in the UK' 3 European Business Organization Law Review (2012): 264.

[617] *The Queen on the application of British Bankers Association v The Financial Services Authority, The Financial Ombudsman Service v Nemo Personal Finance Ltd* [2011] EWHC 999 (Admin) para 77.

The decision must be motivated and may include a money award against the respondent up to £150,000.[618] Compensation can include both financial and non-financial losses (e.g. pain and suffering, reputational damages, distress or inconvenience) whether or not a court would award compensation.[619] The FOS must publish the annual review and its decisions are publicly available in full on its website.[620]

The dispute is resolved depending on the FOS' determination of what is "fair and reasonable in all the circumstances of the case" (s. 228 FSMA 2000). To this end, the FOS takes into account the relevant: (i) law and regulations; (ii) regulators' rules, guidance and standards; (iii) codes of practice; and (iv) (where appropriate) what he or she considers to have been good industry practice at the relevant time.[621] Unlike a court, the Ombudsman is not competent to annul or rescind the contract.

National courts have constantly reiterated that the FOS is not bound by common law.[622]As Rix L J put in R (*on the application of Heather Moor and Edgecomb Ltd v Financial Ombudsman Service Ltd*), "the efficient and cost-effective and relatively informal type of alternative dispute resolution should not be stifled by the imposition of legal doctrine; on the other hand transparency, consistency and accessibility as to the principles which inform the ombudsman's determinations remain virtues in this new setting; and that publicity as to those principles and those determinations can assist in that regard".[623]

Taking into account the need for balancing the FOS' discretion with the need of minimum consistency and transparency in its decision-making, national courts have established that whether or not correct advice has been given according to the relevant regulatory law or whether causation has been established are not relevant

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[618] If the Ombudsman considers that fair compensation requires payment of a larger amount, he or she may recommend that the respondent pays the complainant the balance (DISP 3.7.6).

[619] DISP 3.7.2.

[620] Section 7 of the Sch. 17. The FOS decisions are published on the FOS website since 1 April 2013.

[621] DISP 3.6.4.

[622] See in particular *R. (on the application of IFG Financial Services Ltd v FOS v Mr and Mrs Jenkins* [2005] EWHC 1153., para 13.

[623] *R. (on the application of Heather Moor and Edgecomb Ltd v FOS* [2008] para 89. See also *The Queen on the application of British Bankers Association v FSA, FOS v Nemo Personal Finance Ltd* [2011] EWHC 999 (Admin) para 82.

tests for the FOS adjudication[624] and that FOS could determine a complaint outside the common law limitation periods.[625] In the same vein, the amount of compensation shall not necessarily correspond to the respondent's liability but to the amount which the FOS 'considers (and again that implies a subjective consideration), subject to the limits of reasonableness, fair compensation for loss or damage falling within subsection.'[626] The FOS, however, and differently from courts, should take into account the Principles of FCA's Handbook in deciding what would be fair and reasonable and what redress to afford.[627]

D) Nature and effects of the decision

The complainant has the right to refuse or accept the FOS' decision. If the complainant rejects the FOS' decision, neither party will be bound by it.[628] If the complainant accepts the FOS' decision, the decision is binding on both parties, is enforceable,[629] and precludes the parties from bringing a claim based on the same facts in courts.[630] Therefore, the FOS decisions are not administrative decisions but should be considered as judicial decisions for the purposes of the requirements of *res judicata*.[631] The ECtHR confirmed that the FOS is a 'court or tribunal' for the purposes of Article 6 of the ECHR.[632] The Strasbourg Court also decided that the FOS' procedure meets the

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[624] *R. (on the application of Green v FOS v Gillian & Edward Gunner* [2012] EWHC 1253 (Admin), para 38.
[625] *R (on the application of Bamber & BP Financial Services) v FOS* [2009] EWCA 593.
[626] *R. (on the application of IFG Financial Services Ltd v FOS v Mr and Mrs Jenkins*, para 19.
[627] *R. (on the application of British Bankers Association) v FSA* [2011] EWHC 999 (Admin) para 77. The Court held that the Principles of the FSA's Handbook related to the PPI compalints 'are of the essence of what is fair and reasonable'.
[628] DISP 3.6.6.
[629] DISP 3.7.13.
[630] See *Clark & Anr v In Focus Asset Management & Tax Solutions Ltd v FOS* [2014] EWCA Civ 118 and *Andrews v SBJ Benefit Consultants* [2010] EWHC 2875 (Ch)).
[631] Clark & Anr v In Focus Asset Management & Tax Solutions Ltd v FOS, para 82. See also See Memorandum of Evidence submitted to the House of Commons Treasury Committee (deputy chief ombudsman, David Thomas, May 21, 2007), para.3. 'The [FOS] is not a regulator. It resolves individual disputes as an alternative to the civil courts. The statutory and procedural arrangements concerning [its] structure and accountability are designed to be appropriate for a quasi-judicial and not a regulatory role.'
[632] ECtHR, Heather, Moor and Edgecomb v. the United Kingdom (dec.), no 1550/09, 14 June 2011 and Heather, Moor and Edgecomb v. UK, no. 30802/11, 26 June 2012.

standards of Article 6 because is justified by the need of providing for an efficient dispute resolution mechanism in order to protect consumers in the domain of financial services and investment advice. Importantly, the Court also found that the 'Ombudsman's discretion does not breach the principle of foreseeability, that is an integral part of the rule of law, because the FOS' decision explain in detail the motivation for the decision and there is no sign of arbitrariness.

The FOS decision cannot be appealed but it can challenged by way of judicial review on the basis that the determination was not, in fact, fair and reasonable or by way of defence (on public law grounds) against an action to enforce the award.[633] The judicial review of the FOS does not go so far as to determine whether the FOS has correctly decided the issue at stake (e.g. if advice was properly given) but considers whether "the FOS' 'opinion as to what is fair and reasonable in all the circumstances of the case is perverse or irrational".[634] For example, in a case where the High Court annulled the FOS' decision, it was decided that there must be a logical connection between the breach found and the redress given to the investor (e.g. if the FOS found that the investors would not have invested too much in the product if they had received a good advice, the redress cannot put the investor in the position in which he or she would have been had no investment been made).[635]

D) Patterns of disputes and adjudicative approach

The majority of disputes (56%) concern complaints about the sale and advice of PPIs. A further 31% of disptues concern banking and credit contracts (e.g. current accounts, consumer credit, mortgages) and only 4% of disputes relate to complaints about sales and advice investment service and pension plan contracts, amounting to

[633] Bunney v Burns Anderson Plc [2007] EWHC 1240 (Ch): enforcement of direction under s.229(2)(b) under s.229(9)(a).
[634] *R. (on the application of IFG Financial Services Ltd v FOS v Mr and Mrs Jenkins*, para 13. See also P. E. Morris, FOS, 2008.
[635] R. *(on the application of Garrison Investment Analysis) v FOS*, para 26.

approximately 14,500 cases.[636] The majority of these complaints, however, deal with mortgage endowments, life policy schemes and pension schemes (41%) and only 30% concern typical financial products (derivatives and other products) or investment services (portfolio management).[637] The data available show that the FOS decides the disputes on the basis of the 'fair and reasonable' criteria rather than financial regulation and common law principles; this adjudicative approach attaches therefore greater importance to the concrete facts of the case and the contractual documentation, than the common law principles.[638] As the Hunt's review underlined, the informal adjudication approach and the lack of precedent reveals that the FOS, despite its institutional links with the FCA, cannot be regarded as a regulatory or supervisory body and is not bound by the rules that ensure the proportionate exercise of regulatory power.[639] At the same time, however, this adjudicative approach means that the FOS's decisions can diverge not only from the common law but also regulatory standards and that the same matter can be decided in different ways depending on the actual facts at stake.[640]

Non-advised sales

A high number of disputes concerned the question whether the firm gave an advice service to the client or whether the firm merely gave an execution only service. To consider this question, the FOS mainly took into account the concrete circumstances of the case and the documentary evidence available (e.g. email exchanges between the parties, declaration of the client in the MiFID questionnaire). In one case the FOS concluded that a firm cannot make implicit recommendations or advice to clients in the absence of an advisory contract because this could place the client in a more

[636] In 2011 the investment service related disputes accounted for 7.5% of the total of disputes deal with by the FOS (15,483 cases).
[637] Therefore, in 2016 only 1,967 complaints concerned derivatives and other complex products and only 1,166 complaints concerned portfolio management.
[638] A search by the word 'MiFID' in the FOS decision database shown only nine results between 1.1.2012 and 24.6.2017. A search by the word 'COBS' gave only 413 results in the same period. On average between 2012 and 2016 the FOS resolved 15,000 complaints per year.
[639] The Hunt Review, The Independent Review of the Financial Ombudsman Service. 2008, p. 40.
[640] See Hunt Review. The Independent Review of the Financial Ombudsman Service, p. 41.

precarious situation that he or she would have been without the advice.[641] In several decisions, regarding the alleged mis-selling of contracts for difference (CfD), distributed under execution-only agreements, the FOS undertook a complete assessment on whether the firm respected the appropriateness rule (COBS 10.2) and concluded that the warning that the product was not appropriate for the client could not be considered as an 'oxymoronic clause' and the firm could not be held responsible for the loss suffered by the client.[642]

Advised sales and portfolio management

Also in the disputes concerning complaints for unsuitable advice or portfolio management, the FOS undertook a concrete examination of the facts at stake (i.e. whether the sum invested was proportionate in comparison to the total amount of investor's portfolio)[643] in order to decide whether the financial service was suitable to the risk profile and professional experience of the client. In some cases, the FOS also took into account the suitability rule (COBS 9.2) and examined whether the firm respected all the procedural steps prescribed by that rule, irrespective of whether the firm complied with its duties at common law.[644] Regarding remedies, the FOS reiterated that compensation should put the client in the same position as if he or she had not been given unsuitable advice and this is calculated by comparing the actual investment performance with what could have been achieved from the type of investments that would have been more appropriate.[645]

Interest rate hedging products (IRHPs)

A strand of disputes concerns clients' complaints after the review conducted by the financial firms involved in consumer redress schemes for IRHPs. The FOS has

[641] Ref. DRN7123282.
[642] Ref. DNR8042618 and Ref. DNR5067630.
[643] Ref: DRN0990618 and Ref: DRN3529093.
[644] Ref. DRN0627149 and ref. DNR7476955 (where the FOS applied the Principle 6 from the FSA's handbook according to which a 'firm must pay due regard to the interests of its customers and treat them fairly).
[645] Ref. DRN4404806.

consistently held that the granting of a loan to the client was conditional upon the conclusion of an IRHP contract. However, in many cases the FOS has concluded that the bank, despite the positive outcome of its review, had not properly informed clients on the break cost of the hedging product, thus awarding compensation to the client.[646] The most interesting feature of these decisions is the fact that the FOS dismissed the banks' argument that the recent judgments in *Green and Rowley v Royal Bank of Scotland* shall be applied to these disputes. In these judgments the UK courts decided that the bank's breach of conduct of business rules does not give rise to a remedy in common law.[647] Significantly, the FOS refused to follow these judgments because they 'focussed on application of common law duties, rather than an analysis of the bank's adherence to the Conduct of Business (COB), and other, regulatory rules [and] the judgment was not an assessment of what is fair and reasonable.'[648]

5. Convergent trends and divergences

This analysis has shown several convergent trends: the rise of out-of-court retail disputes ('de-judicialization') and the transformation of ADRs from dispute resolution bodies into quasi-supervisors or quasi-courts.

5.1. The "de-judicialization" of retail client disputes

A common feature across the examined jurisdictions is the move of retail clients disputes out of courts. In retail financial markets, this de-judicialization of disputes, which reflects a broader trend in the EU consumer markets,[649] could be explained by the following main reasons.

[646] Ref. DNR1087405, ref. DNR1544213, DRN2008922.
[647] *Green and Rowley v Royal Bank of Scotland plc* [2012] EWHC 3661 (QB) and *Green and Rowley v Royal Bank of Scotland Plc* [2013] EWCA Civ 1197.
[648] Ref. DNR7426826 and ref. DNR7432617.
[649] See H.-W. Micklitz, A. Wechsler (eds.). The Transformation of Enforcement: European Economic Law in a Global Perspective, Oxford, Hart, 2016.

First, the number of identified misconduct practices put in place by credit and investment firms in the distribution of financial products to clients remains particularly high.[650] The highest number of complaints was registered between 2008 and 2013, reflecting the banking crisis experienced in some Member States (UK, Greece and Spain), when the majority of complaints focussed on low quality or even lack of information provided to investors when they purchase financial instrument (61% in 2012). In 2016 these type of complaints have declined to 16,8%, whilst the complaints about reasons for complaint are unauthorized business and incorrect or inappropriate execution of financial orders have grew up.[651]

Second, there is an increasing awarness of retail clients about their legal rights and an increasing confidence in the institutions managing ADR bodies.[652] In fact, ESMA reported that in 2013 the correlation between problems and complaints was positive (i.e. where investors had more problems they also complained more) only an average 27% of all individuals reporting problems did not lodge a complaint (in France, the percentage rises up to 63% of individuals).[653]

Third, in the examined jurisdictions and in most of most of the Member States, the access to the firm's internal complaints handling is conditional upon the access to ADR,[654] the ADR procedure is free of charge for the client,[655] and the the decision/recommendation of the ADR body does not prejudice access to justice[656].

[650] EBA, Risk Dashboard. Data as of Q2 2016, p. 4.
[651] See EMSA trends, 1/2016, p. 20 and ESMA, Trends, Risks and Vulnerabilties, 2/2016, p. 19.
[652] However, the level of trust in the banking and financial services in the EU remains considerably lower than in the US, Canada and Japan. See ESRB, Report on misconduct risk in the banking sector June 2015, p. 7.
[653] FCA. Encouraging consumers to claim redress: evidence from a field trial, April 2013.
[654] An exception is Finanč ní arbitr Č eské republiky CZ and the German Ombudsmann der deutschen genossenschaftlichen Bankengruppe c/o Kundenbeschwerdestelle beim Bundesverband der Deutschen Volksbanken und Raiffeisenbanken (BVR), Austrian Gemeinsame Schlichtungsstelle der Österreichischen
Kreditwirtschaft where no formalities should be complied with before submitting the complaint.
Name in English Ombudsman of German Cooperative Banks
[655] An exception is Ankenævnet for Fondsmæglerselskaber in Denmakr.
[656] In Ireland and the UK the decision of the ombudsman can be appealed before national courts.

These procedural safeguards facilitate access to justice and renders the traditional court-proceeding less attractive for the retail clients, due to their costs and length.

5.2. From dispute resolution to supervision and enforcement: The ADR as 'quasi-supervisors' and 'quasi-court'

The second common trend across the examined jurisdictions – which is part of a broader trend towards the 'formalisation and juridification'[657] of ADRs – is the transformation of ADRs into mechanisms which ensure compliance with regulatory and supervisory standards and guarantee the effective application of private law.

Fig. 2: The adjudictive approaches and functions of the ADRs

	Dispute resolution	Supervision	Enforcement
Informal approach	French Mediation schemes		
Formalistic approach		Italian Ombudsman, Spanish CNMV, UK FOS	
Legalistic approach			Italian ABF, Spanish DCMR

5.2.1. The ADRs as 'quasi-supervisors'

The transformation of ADR in quasi-supervisors is mainly driven by their integration into the institutional design of supervisory authorities as well as by their formalistic

[657] See also J. Zekoll, M. Bälz, I. Amelung. 'The Changing Face of Dispute Resolution Formalisation and juridification' in J. Zekoll, M. Bälz, I. Amelung (eds.). Formalisation and Flexibilisation in Dispute Resolution. Leiden, Boston: Brill, Nijhoff, 2014, 3.

approach in adjudication.[658] The 'supervisory ADRs', in comparison to the private-based ADRs, typically based on mediation schemes (France), are generally based on adjudicative schemes, such as ombudsmen, and take decisions that produce legal effects on the financial firm, either because the non-compliance is published as a form of reputational sanction (ABF and ACF in Italy) or because challenge the non-compliance in court (FOS in the UK). Therefore, a correlation exists between the public/private nature of the body and the legal effects of its decisions (the majority of ADR bodies which issue legally binding decisions are public-based bodies).[659]

The integration of the ADR function in the investor protection'supervisory mandate adds to the traditional dispute resolution function of the ADRs, the new regulatory function of contributing to the achievement of a high level of client protection.[660] The ESAs have indeed recently confirmed that the data from the complaints received by the NCAs, and from the ADRs and courts help firms to monitor compliance with regulatory standards and help supervisors to conduct an effective supervision.[661]

Besides this investor protection function, 'quasi supervisory' ADRs have *de facto* acquired also a *lato sensu* prudential function, that is to mitigate the potential systemic risks arising from mass retail litigation. The recent tendency, evidenced in Italy and Spain, to set up special purpose ADRs specifically aims to compensate clients for widespread mis-conducts of firms subject to insolvency or resolution proceedings. However, these special purpose ADRs raise some concerns from a deterrence and client protection perspective. Whilst these special-purpose ADR seem to reach a fair balance between compensating quickly investors and ensuring the stability of the

[658] See H.-W. Micklitz. 'The Transformation of Enforcement in European Private Law: Preliminary Considerations' 4 European Review of Private Law (2015): 502.
[659] The exceptions are the Italian ombudsman giuri, the Danish Ankenævnet for Fondsmæglerselskaber, and the German (Ombudsmann der privaten Banken, Ombudsstelle Geschlossene Fonds e.V, Ombudsstelle für Investmentfonds), where the private-based ombudsmen issue binding decisions.
[660] See in this sense, with respect to the telecom sector, M. Cantero Gamito, "Dispute Resolution in Telecommunications: A Commitment to Out-of-Court", 2 European Review of Private Law (2017): 387–420.
[661] See ESMA. Report on Trends, Risks and Vulnerabilities No. 1, 2017, p. 37 and EBA. Guidelines on product oversight and governance arrangements for retail banking products. EBA/GL/2015/18 15 July 2015, p. 55.

financial system, their effects on deterrence remain doubtful, because compensation is not paid by the wrongdoer (but by the state or public funds). Also their compatibility with the principle of effective judicial protection and the principles governing consumer ADRs is questionable.[662] Even if the participation of the client to these ADR is voluntary and therefore, *stricto iure*, this procedure cannot restrict access to justice for clients, there is a risk that the party who could be ultimately held responsible for the compensation (e.g. FROB or public fund) is also the party who approves the appointment of the person in charge of resolving the dispute, in contrast with the provisions of Article 6(1) of the Directive on consumer ADR.

5.2.1. The ADRs as "quasi-courts"

The ADR as 'quasi-courts' decide the dispute not only on the basis of the parties' behaviour (informal approach) or contractual documentation (formalistic approach), but on the basis of national private law standards (legalistic approach). The driver for the transformation of ADRs into 'quasi-courts' is threefold.

First, the adoption of an adjudicative, instead of a facilitative, model of ADR makes the out-of-court dispute resolution closer to a court-adjudication; this institutional feature, in turn, has generally led ADR bodies to decide disputes in a legalistic way, namely by applying legal principles and case law.

Second, EU law, and recently, the ADR Directive has attached to ADR procedures a law enforcement function in order to protect the vulnerable party (Article 9(2) and 11).[663]

Third, the formalisation of supervisory standards and the 'integration' of out-of-court dispute resolution into the (client protection) mandate of the NCAs strenghtens the

[662] The Directive on consumer ADR is applicable in so far as the client eligible for these ADR schemes qualify as consumers.
[663] G. Wagner. 'Private Law Enforcement through ADR: Wonder Drug or Snake Oil?' 51 *Common Market Law Review* (2014): 176.

link between dispute resolution, supervision and effective application of the law. Although the ADR decision-making body (individual or panel) panel shall be independent from the NCA, the ADR itself is not independent and fully separate from the NCA: the latter generally keeps the power to appoint/remove the ADR's panel members, to provide funding and administrative structures to the ADR and to publish the annual reports.

Due to the lack of full independence from supervisory authorities, it is doubtful whether ADR bodies qualify as court or tribunals for the purposes of referring questions to the CJEU for a preliminary ruling.[664] In *Syfait*, where the CJEU held that a Greek competition authority cannot be considered as a court or tribunal, the CJEU clarified that personal and operational independence of its members does not ensure independence, unless specific guarantees are in place to in respect of their dismissal or the termination of their appointment.[665] In this case the CJEU did not follow the Opinion of the Advocate General Jacobs who, instead, convincingly argued that admitting a reference from this body "would favour allowing a reference to be made at the earliest possible stage, it would also ensure that a reference to the CJEU is made by a specialised entity rather than a generalist court charged with the review of an adminsitrative decision at a later stage".[666]

The same arguments hold true also for the ADRs competent for retail financial disputes and can be supported by Article 69 of the MiFID II which, by requiring Member States to compensate, through extra-judicial mechanisms, client's losses derived from firms' breach of the MiFID II or MiFIR implicitly establishes a link between the need of ensuring extra-judicial enforcement and effectiveness of EU law. As a logical consequence, and given that the effectiveness of EU law is ultimately ensured by the

[664] See J. Rodriguez Medal. 'Concept of a Court or Tribunal under the Reference for a Preliminary Ruling: Who can Refer Questions to the Court of Justice of the EU?' 8 European journal of legal studies, (2015): 136.
[665] Case C-53/03, *Syfait and Others*, ECLI:EU:C:2005:333, para 31.
[666] Opinion AG Jacobs in case C-53/03, *Syfait and Others* ECLI:EU:C:2004:673, para 46.

Union courts, it would be logical to admit that the ADR competent for the resolution of the MiFID disputes, can refer cases for a preliminary ruling to the CJEU.

Chapter 6 – THE ROLE OF NATIONAL COURTS IN FINANCIAL LITIGATION

1. Mis-selling litigation before and after the crisis: patterns and evolutions

In this context of increasing complexity and overlap of conceptual categories (public law vs private law, regulation vs autonomy) the role played by national courts before and after the crisis becomes a crucial indicator to understand how the EU-derived financial regulatory standards have affected private law and how this influence can protect the clients affected by firms' mis-conducts. The EU conduct regulation was originally meant to be enforced by NCAs and by out-of-court dispute resolution mechanisms. However, in the wake of the crisis, national courts[667] have become actively involved mis-selling litigation and have increasingly used the ISD and MiFID I conduct duties as a yardstick to define the firms' pre-contractual and contractual obligations and to grant contractual or tortious remedies to investors.[668]

What are the reasons for the increasing influence played by the EU-derived regulatory duties in financial litigation after the global financial crisis? There is a regulatory-related and a crisis-related reason.

The regulatory-related reason is that the MiFID I, which became applicable into Member States little time before the burst of the crisis,[669] regulated for the first time the 'investment advice' and, more importantly, introduced the distinction between the stricter suitability rule (for advised services and portfolio management) and the less strict appropriateness rule (for non adviced services). Hence, whereas before the transposition of the MiFID I the distinction between adviced and non-adviced sales of financial instruments was essentially based on the traditional private law dichotomy

[667] This chapter considers only the role of civil and/or commercial courts – it does not consider the role played by administrative courts, especially in the judicial review of acts adopted by the EU and national competent authorities.

[668] See O. O. Cherednychenko. 'Contract Governance in the EU', 500; D. Busch. 'The Private Law Effect of MiFID I and MiFID II' in D. Busch, G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, 176; M. Andenas, F. Della Negra. 'Between Contract Law and Financial Regulation', 499.

[669] MiFID I had to be transposed by 31 January 2007 and had to be applied from 1 November 2007 (Article 70).

between mandate and sale contract of sale, after its transposition it became a EU law requirement which can therefore strongly influence the interpretation of general private law.

The crisis-related reason is that the infamous bankruptcies, in the EU and the US and the consequent worsening of market conditions caused large scale losses to retail clients and this, in conjunction with the widespread mis-conduct of financial firms, increased the volume of litigation before national courts. Whilst the pre-crisis litigation was mostly related to individual mis-selling, typically concerning complex financial products distributed to sophisticated clients, the post-crisis litigation concerns large scale mis-selling caused by the distribution of high risk products to retail, unsophisticated clients who were not made aware of the worsening of the financial and solvency condition of the issuer.
Another recurrent strand of post-crisis litigation was triggered by the impact of the adverse market conditions on financial derivatives and, in particular, interest rate swaps. The interest rate swaps were concluded by investors, on the bank's implicit or explicit recommendation, to offset the expected increase of the (variable) interest rate of other financial products (typically a mortgage). However, when interest rates of the mortgage unexpectedly began to fall, after the Lehman Brothers' collapse, the investors were required, according to the interest rate swaps, to offset the difference to the bank. This triggered, in many jurisdictions, the claims (not only by retail sophisticated but also sophisticated investors) against the firm distributing the swap, which was also, the investors' contractual counterparty.

Against this backdrop, the main purpose of this chapter is to explore, by examining these litigation patterns, how the EU-derived conduct of business rules have affected the interpretation of national private law and have contributed to the protection of retail clients. To this end, the chapter, after illustrating the main patterns of litigation experienced in the four jurisdictions, focusses on two main questions. First, whether national courts may impose stricter private law duties or remedies on the financial firm, regardless of whether national law confers an express statutory remedy to the

investor for the firm's breach of conduct of business rules (like in the UK) or not (like in Italy, Spain and France).[670] Second, in the case that a remedy is granted to the investor, whether this remedy has compensatory (i.e. it compensates for the loss) or restitutionary (i.e. it gives back to the investor the entire purchase price of the security) effects and how EU regulatory standards influence its constitutive conditions (e.g. causation, burden of proof).

2. The national models

2.1. Italy

2.1.1. Patterns of litigation

Between 2005 and 2008 courts have been inundated by a wave of litigation related to the mis-selling of bonds issued by the Republic of Argentina ("Argentina bonds"), the Cirio Group ("Cirio bonds") and the Parmalat Group ("Parmalat bonds").[671] The large detriment caused to retail clients was primarily due to the systematic breach of conduct rules laid down by Law 1/1991 and the Legislative Decree 58/1998 and the CONSOB Regulation 1152/1998 and by the distribution strategy of financial firms. These products were sold to retail clients without prospectus *and* rating (except for the Argentina bonds) and often before the issuance (so called 'grey market').

[670] See also for this research question D. Busch. 'D. Busch. 'The Private Law Effect of MiFID I and MiFID II' in D. Busch, G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, 176.

[671] See in detail A. Perrone-S. Valente. 'Against All Odds: Investor Protection in Italy and the Role of Courts' 13 European Business Organization Law Review (2012): 31 ss. The Authors held that between 2005 and 2009, only the Tribunal of Milan, the most experienced in financial and corporate litigation, has decided 311 cases concerning the mis-selling of bonds certificates issued by the Republic of Argentina, Parmalat and Cirio. Unfortunately, as most of the judgments of the lower Courts are not reported and published in legal databases, it is difficult to estimate the exact number of lawsuits brought by investors in these cases. Therefore, data can be relied upon only in relation the 'minimum' threshold. In this respect, until now, 45 judgments have been decided on Parmalat bonds (2 Supreme Court); 86 on Cirio bonds (20 Supreme Court); and 127 on Argentina bonds (1 Supreme Court). Data available at www.dejure.it. and www.ilcaso.it It should also be remembered that It is worth recalling that in 2004, after the Cirio and Parmalat scandals, the fines imposed by the CONSOB on financial intermediaries rocketed to EUR 14.2 million, whereas between 1999 and 2012 the amount of fines was between EUR 1.3 million (1999) and EUR 3.1 million (2002).See CONSOB. *Annual report for 2004*, p. 176.

After the financial crisis, the financial disputes concerned mainly concerns the mis-selling of the Lehman Brothers securities in relation to breach of Article 21 of the Legislative Decree 58/1998, which transposed the ISD, and the CONSOB Regulation 1152/1998. It is noteworthy that Article 28 and 29 of this CONSOB Regulation had already introduced a 'suitability rule' which applied also to all investment services (including execution-only services, now subject to the MiFID's appropriateness rule) and required the firm to abstein from distributing financial instruments that are not suitable, unless the client gives an express, written consent.adoption of the MiFID I, adoption duties in execution only services. Another strand of claims concerned the mis-selling of interest rate swaps. In these cases, clients alleged the breach of the appropriateness and suitability rules laid down in the CONSOB Regulation 16190/2007, which transposed the MiFID I.

2.1.2. Whether national private law is stricter than EU conduct regulation

The main questions that arose in the case law concern the interpretation of the conduct of business rules, in particular conflict of interest and suitability rules, and the private-law consequences (remedies) deriving from their contravention.

A) Non-advised services

Almost all litigation regarding Parmalat, Cirio and Argentina bonds concerned firms' breaches of the suitability rule of CONSOB Regulation 1152/1998 in execution only services. The Supreme Court clarified both the scope and intensity of this suitability rule.[672] Regarding the suitability rule's scope, the Supreme Court in 2008, in a case concerning Mexico bonds, overturned the decision of the Court of Appeal, by helding that the '"suitability rule" laid down in Article 28 CONSOB Regulation (and previously

[672] See for a comment on the Italian suitability rule: F. Capriglione. Intermediari finanziari, investitori, mercati, Padova: CEDAM, 2008, p. 147–156; F. Greco. Informazione pre-contrattuale e rimedi nella disciplina dell'intermediazione finanziaria, Milano, Giuffrè, 2010, p. 44–60.

in Articles 5 and 6 of CONSOB Regulation 1997, applicable *ratione temporis*), is different and stricter than that deriving from the principle of good faith laid down in the civil code' and shall apply also to execution only services and to all non-professional clients, even if they have previously invested in risky securities.[673] This judicial principle is extremely important. First, because it anticipates, *de facto,* the content of the MiFID's 'appropriateness rule' which was introduced, besides the 'suitability rule' precisely to enhance the client's protection in non-advised services, where the financial instrument is distributed on the client's initiative. Second, because it shows that private law duties, based on the general pre-contractual duty of good faith (Article 1337 c.c.) can be stricter than regulatory duties. [674]

As regards the intensity of the 'suitability rule', a recurrent defence by the financial firm is that the client was provided with a document on risks and that he or she received information about risks. However, the Supreme Court repeatedly held that the information to be provided to the client under Article 28(2) CONSOB Regulation should be concrete and effective – the information cannot be standardized[675] or contain technical jargon or complicated syntax (e.g. obscure sentences, use of subordinated sentences).[676] In addition, in relation to Argentina bonds, the Supreme Court held that the client's declaration that the financial instrument is adequate does not ensure the full compliance with the suitability rule because this provision aims to protect the client against the risk of not being adequately informed and cannot be used by the bank in order to shield is liability in civil claims.[677]

However, in relation to the mis-selling of Lehman Brothers' bonds, the Italian lower courts are divided as to whether the firm failure to inform clients about the counterpary risk of Lehman Brothers Group is a breach of the suitability rule. Some Tribunals dismissed investors' claims for compensation because the firm could not be

[673] Cass., 25 June 2008, n. 17340. See also Cass., 7 June 2016, n. 15269. Available on www.ilcaso.it (all the subsequent judgmetns of Italian courts are available on the same website).
[674] See Cass., 3 July 2014,n. 15224.
[675] See App. Milano, 15 December 2015, n. 4784 and, recently, Cass., 18 May 2017, n. 12544.
[676] Cass., 3 April 2014, n. 7776.
[677] Cass., 25 September 2014, n. 20178 and Cass., 6 agosto 2014, n. 17726.

expected to inform the investor about the unforeseeble Lehaman bankkruptcy,[678] given that its securities were rated very high by financial advisers (e.g. 'Consorzio Patti Chiari').[679] An increasing number of Tribunals, however, held the firm had breached its suitability rule because, even if it could not be required to have foreseen Lehman's collapse, it should have determined the high risk of these securities by assessing, in addition to the rating, the deteriorating situation of the Lehman Brothers Group after 2007, the client's amount of money invested, and the nature of the client. [680]

The Italian Supreme Court has not yet delivered a judgment on the interpretation of the MiFID-derived conduct of business rules. The Tribunal of Verona recently decided that a firm had breached the appropriateness principle under (Article 41 and 42 CONSOB Regulation No 16190/2007) because it did not inform the client about the risks deriving from the illiquid nature of the securities.[681] In particular, the Tribunal considered that a generic warning of illiquidity is not sufficient to inform a client about the risks of the securities. The Tribunal granted the client compensation for damages in the amount of the purchase price, given that these securities, being illiquid, could not be sold out by the client.

B) Advised services and portfolio management

[678] See, Trib. Monza, 24 February 2014, n. 605; Trib. Firenze, 20 February 2014, Trib. Roma, 8 November 2013, n. 898; Trib. Roma, 6 September 2013, n. 17856; Trib. Torino, 20 November 2012; App. Trieste, 11 May 2012; Trib. Venezia, 5 November 2009; Trib. Palermo, 5 April 2011.

[679] This banking association was established in 2003, with the purpose of improving the financial literacy of retail clients by listening the securities (bonds and shares) that had high ratings (between AAA and A) and low VaR (Value at risk index). The European Commission decided not to open an investigation regarding the alleged breach of Article 101 TFEU, claimed by several Italian investors, of Consorzio Patti Chiari and subsidiaries of Standard & Poor's, Moody's e Fitch with regard to the rating assigned to bonds issued by Lehman Brothers Group (COMP/39803 Associazione Italiana Risparmiatori Obbligazionisti Lehman Brothers contro Consorzio Patti Chiari, Banche Consorziate e Agenzie di Rating, Bruxelles, 30.11.2011 SG-Greffe(2011) D/21836 C(2011) 8935 def)

[680] See in particular Trib. Salerno, 20 October 2012. which underlined that already in 2007 Lehman Brothers had fired about 1,200 employees, in 2008 accumulated losses on mortgage securities by $ 2.8 billion and at the end of August 2008, Lehman shares had lost 73% of their value. See also App. Trieste, 18 December 2014; Trib. Verona, 19 March 2013; Trib. Modena, 15 July 2011, n. 1190; Trib. Torino, 22 December 2010, n. 7674. See Tribunale Massa 22 October 2015.

[681] Tribunale di Verona, 21 Marzo 2017.

Given that the pre-MiFID regulatory framework did not differentiate between adviced and non-advised services, the previous judgments of the Supreme Courts apply also to adviced and portfolio management. In the post-MiFID framework, the Court of Appeal of Milan decided that the firm failed to assess the suitability of the interest rate swap under Article 40 of the CONSOB Regulation No 16190/2007, *inter alia* because of the disproportion between the amount of the swap (notional amount: EUR 3 million) and the client's debt (EUR 540,000).[682] The Court, therefore, upheld the termination of contract decided by the tribunal.

With regard to portfolio management services, the Supreme Court, in the pre-MiFID framework, decided that traditional rules governing of the contract of mandate – under which the delay of the principal (mandante) to approve the transaction of the agent (mandatario) determines the tacit approval of the transaction – cannot apply to the portfolio management because this service aims at providing 'surplus of protection' to the client and therefore is not compatible with the general principle of tacit approval of the transaction of the civil code.[683] For the same reason, the Supreme Court decided that the client has the right to be properly informed and advised over the entire duration of the contractual relationship[684] – thus anticipating a requirement introduced by the Commission MiFID II Regulation (Article 62).[685]

Another vexed issue was whether the instructions given by the client to the financial firm, acting as a portfolio manager, are binding on that firm. In a recent case, where two unsophisticated retail investors invested a large sum of money in bonds issued by an Icelandic bank, nationalized after the banking crisis, the Supreme Court decided that even if the instructions given by the client to the bank are binding. The Supreme Court, whilst noting that Article 24 CONSOB Regulation literally provides for their binding character, decided that the instructions are not biding and the client can

[682] App. Milano, 26 May 2016.
[683] Cass., 24 February 2014. Compare it with Cass., 5 February 2013, n. 2736, which noted that the 'investment contract' aims to protect clients by including in its scope financial instrument that would not be regualted by the civil code.
[684] Cass., 24 February 2014, n. 10306 and Cass., 3 April 2014, n. 7776.
[685] See Chapter 2, above.

withdraw from the contract if he or she realises that the investment is not suitable.[686] This is because the firm, given his or her professional expertise, shall always assess whether the client's instruction is adequate and suitable for his or her profile.

2.1.3. The private law remedies for the breach of conduct of business rules

A) The avoidance of contracts for the breach of mandatory rules of public order

In the absence of an express private law remedy for the breach of conduct of business rules, the issue arises what civil law remedy can be granted to the clients. Between 2004 and 2007 several Tribunals decided, especially in relation to the Parmalat, Cirio and Argentina bonds, that, since these conduct of business rules qualify as imperative rules of economic public policy, the breach of these rules determines the absolute nullity of the contract under Article 1418(1) c.c. and the restitution of the sums paid by the client.[687] To support this argument, some Tribunals held that the ISD-derived conduct of business rules implement the principle laid down by Article 47(1) of the Constitution which 'encourages and safeguards savings in all its forms' and therefore should be interpreted as to ensure the the public interest in the protection of investors and the orderly functioning of financial markets.[688]

By contrast, other Tribunals and the Supreme Court, whilst considering these rules as mandatory, did not regard them as imperative rules of economic public policy[689] and therefore decided that their breach can only give rise to pre-contractual (Article 1337

[686] Cassazione civile, sez. I 17 aprile 2015, n. 7922 - Pres. Forte - Est. Didone., p. 30.

[687] See for an overview . V. Roppo, G. Afferni, *Dai contratti finanziari al contratto in genere: punti fermi della Cassazione su nullità virtuale e responsabilità precontrattuale*, in *Danno resp.*, 2006, 25 ss. On Argentina bonds: Trib. Ferrara, 25 February 2005; Trib. Mantova, 10 December 2004; Trib. Mantova, 22 March2007. On the Cirio bonds, see: Trib. Palermo, 14 January . 2010; Trib. Trani, 31 January 2006; Trib. Novara, 10 January 2006; Trib. Reggio Emilia, 22 December 2005; Trib. Roma, 3 December 2005. On the Parmalat bonds see: Trib. Venezia, 16 February 2006; Trib. Venezia, 29 september 2005; Trib. Parma, 13 April 2005.

[688] See in particular Trib. Parma, 13 April 2005.

[689] See, in particular, Cass., 29 September 2005, n. 19024, in *Foro it.*, 2006, I, 1105 ss.

c.c.), contractual liability (Article 1218 c.c.) [690] and termination of contract, if the breach of rules is sufficiently serious (art. 1453 c.c.).[691] The very issue at stake, therefore, was whether conduct of business rules qualify as 'contractual rules', which determine the content of the contract (*regole di validità*), or rules that, albeit mandatory, do not determine the contract's duties but only the parties' duties before and after the conclusion of the contract (*regole di comportamento*).

In 2007 the Plenary Session of the Supreme Court, in a case concerning the mis-selling of a derivative contract concluded under the pre-ISD regime (Law 1/1991), was called upon to solve this conflict, and to decide whether the breach of the business rules of conduct determine the nullity of the contract under Article 1418 (1) c.c.[692] The Supreme Court decided, in two judgments, that the pre-ISD conduct of business rules (equivalent to the MiFID fair treatment clause) do not do not define structural elements of the contract ('regole di validità') but set down the pre-contractual and contractual conduct of the parties ('regole di comportamento').[693] Therefore, their breach cannot give rise to remedies which affect the validity (or structure) of the contract (i.e. absolute nullity of contract under Article 1418 c.c.) but only to the pre-contractual (Article 1337 c.c.), contractual (Article 1218 c.c.) liability or the termination of contract (Article 1453 c.c.).[694]

These landmark judgments have been subject to strong criticism not only because the distinction between the *regole di validità* and *regole di comportamento* is not expressly

[690] In general, the contracts for the purchase of bonds were preceeded by a master agreement whereby the general rights and obligations are stated. Based on this framework agreement parties further conclude executions orders to sell or buy securities.
[691] See for instance for the Cirio bonds: Trib. Verona, 23 December 2008; Trib. Como, 7 February 2007; Trib. Rimini, 7 December 2006; Trib. Milano, 20 March 2006; Trib. Parma, 3 March 2006..
[692] Cass. Sez. Un., 19 December 2007, n. 26724, 26725. See for a comment A. Gentili, *Disinformazione e invalidità: i contratti di intermediazione dopo le Sezioni Unite*, in *Contratti*, 2008, 393 ss.; D. Maffeis, *Dopo le Sezioni Unite: l'intermediario che non si astiene restituisce al cliente il denaro investito*, in *Contratti*, 2008, 555 ss., in Danno e resp., 2008, p. 525 ss.
[693] On the distinction between *regole di validità* e *regole di comportamento,* see G. D'Amico. *Regole di validità e principio di correttezza nella formazione del contratto*, Napoli, 1996.

[694] See also Cass., 17 February 2009, n. 3773, in *Danno e resp*., 2009, p. 503 ss.

laid down in the civil code and appears to be excessively formalistic code[695] but also because it remains unclear how each rule should be identified and why conduct of business rules, whilst qualifying as *regole di condotta*, extraneous from the content of contract, can, nevertheless, give rise to the breach of contract.[696] Indeed, the very rationale of these judgments seems to be to replace the 'investor-friendly' automatism between the breach of conduct of business rules and restitution with a case-by-case approach where the restitution is the effect of the termination of contract for the sufficiently serious breach of conduct rules.[697]

B) The liability for damages and termination of contract

Whilst the financial firm has to prove compliance with standards of duty and care laid down by financial regulation, in accordance with Article 13 of the Law 1/1991 (now Article 23 TUF),[698] the client must prove the causal link between the firm's breach of conduct rules and the loss and the amount of recoverable damages. As to the proof of causation, the Supreme Court has recently decided, with regard to Cirio/Parmalat bonds, that the breach of conduct of business rules, especially when the securities are not rated, is the cause of the client's loss.[699] The Supreme Court started from the assumption that the 'reasonable investors is risk-adverse'[700] and therefore the choice between differeent investment options is crucially driven by the information available. Therefore, the lack of information on the rating of securities is an element that could have raised a legitimate doubt in the investor about the adequacy of his or her investment. The Court applied the causation standard of 'more likely than not', rather than the stricter standard of the *condictio sine qua non*, between the breach and the

[695] See in particlar G. Vettori. 'Regole di validità e di responsabilità di fronte alle Sezioni Unite. La buona fede come rimedio risarcitorio' 2 Obbligazioni e contratti 2008: 104 and G. Vettori. 'Contract without numbers and without adjectives. Beyond the consumer and the weak enterprise' 9 European Review of Contract law (2013): 233.
[696] Cassazione civile, 7 June 2016, n. 11641 'violazione di obbligo endocontrattuale', p. 5.
[697] See, for instance, Trib. Roma, 7 October 2013; Trib. Milano, 7 May 2013; Trib. Torino, 22 December 2010. For a different view, according to which the breach of the suitability rule may determine the nullity of the contract, see Trib. Venezia, 27 March 2008, in *Nuov. Giur. Civ. comm*., 2008, I, p. 1276 ss.; Trib. Milano, 3 June2008; Trib. Parma, 24 March 2011.
[698] See also in the same sense: Cass., 29 October 2010, n. 22147.
[699] Cass., 3 June 2016, n. 11466
[700] See Cass., 11 April 2016, n. 7071, p. 19.

loss. With regard to 'Cirio bonds', the Supreme Court[701] held that in order to establish a causal link between the breach and the loss, the client does not need to prove that he or she would have invested the money in another financial instruments because the financial firm's breach of conduct of business rules could have prevented the client from making any investment at all.

C) The quantification of damages

As mentioned above, in the overwhelming majority of cases, when the Italian courts found a breach of conduct of business rules they decided to terminate the contract and order the financial firm to give back to the client the sums invested. A recurrent defence of the firm, however, is that the client has contributed to cause the loss (i.e. by deciding not to sell the securities in a timely manner or by not informing him or herself of the risk of securities). On this issue of contributory negligence, the Supreme Court undertook a restrictive view. In a recent case, the Supreme Court specified that only in exceptional cases the client could be held liable, precisely when the client's behaviour is exceptionally imprudent or accomodates violation of rules committed by the financial firm,[702] and the firm's duty to inform cannot be replaced by duty of the client to inform him or herself (e.g. through the press).[703] In addition to this, the fact that the financial firm informed the client, after the purchase of Parmalat securities, and before the Parmalat failure, that he or she should divest or differentiate his or her portfolio, does not indicate that the client is liable for contributory negligence. [704]

The Supreme Court has also clarified the criteria for quantification of losses. In the landmark judgments of 2007, the Supreme Court held that the amount of recoverable damage should not be limited to the expenses incurred by the plaintiff and loss of chance ('reliance damage') but should include also the loss of the expected profit

[701] See Cass., 31 January 2014, n. 2123 and Cass., 19 October 2012, n. 18039.
[702] See Cass., 22 September 2015, n. 18613.
[703] Cass29 December 2011, n. 29864.
[704] Cass., 31 August 2015, n. 17333.

('expectation damages').[705] In this respect, the Supreme Court specified that the damage should amount to the difference between the price paid by the investor and the real value of the security (allegedly lower than the price paid). More recently, however, the Supreme Court criticized this approach because it is not possibe to demonstrate that the real value of securities was lower than the price paid by the client. Rather, the loss is in the fact that the securities 'incorporate a risk of loss of capital that the well-informed client would not have reasonably taken or not in the same measure'.[706] To underpin this reasoning, the Supreme Court recalled the general principle of private law that the owner takes advantages from his or her property and consequently he or she shall have borne the risks for disruption of his or her property. Therefore, the Supreme Court stressed that from the time the client is aware of the risks he or she has to borne the consequeces stemming from the risks, i.e. losses.[707]

D) The avoidance of contracts for lack of cause or lack of consent

With regard to the litigation for the mis-selling of interest rate swaps and derivatives, the Italian courts seem to follow a more investor-friendly approach. Several Tribunals and Courts of Appeal have declared null and void the contracts for lack of cause or lack of consent under Article 1418(2) c.c. The 'leading case' is the judgment of the Court of Appeal of Milan of 2013 which, overturning the first instance court that had awarded only pre-contractual damages to the investor, declared the nullity of an IRS for lack of cause.[708] In this case, the client claimed that the contract did not provide information on the 'mark to market' and other the implicit/hidden costs of the IRS and therefore

[705] Cass., Sez. Un., 19.12.2007, n. 26724, 26725, cit. See also, before, Cass., 29 September 2005, n. 19024.
[706] See Cass., 29 December 2011, n. 29864 p. 24 and Cass., 11 June 2010, n. 14056 regarding the issuer's liability for a misleadng prospectus, commented by G. Afferni. 'Responsabilità da prospetto: natura, danno risarcibile e nesso di causalità' 6 Danno e responsabilità, 2011: 621 and Cass., 12 December 2013, n. 27875, regarding the joint liability of the issuer and intermediary for mis-selling of Cirio bonds, commented by F. Della Negra. 'Il concorso di colpa tra società emittente ed intermediario finanziario: la recente pronuncia della Suprema Corte' in www. Giustizia.civile.com (2014).
[707] See Cass., 29 December 2011, n. 29864, p. 25.
[708] App. Milano, 18 September 2013. See for a comment, D. Imbruglia. 'La creazione razionale dell'alea nei derivati OTC e la nullità dello swap per vizio di causa' in Persona e Mercato (2013): 332. Available on www.personaemercato.it.

the IRS, instead of performing a hedging function, performed a speculative function [709] The Court started from the assumption that IRS entered into for hedging purposes is valid and legally enforceable only if the risk underpinning the parties' obligations (*alea*) is rational (*razionale*) and can be assessed by the client before the conclusion of the contract. [710] The absence of information on the MTM prevents the client from assessing the risks and turns the contract into a gamble, which is not enforceable under general private law.[711]

A similar reasoning was followed also by other Tribunals,[712] including the Tribunal of Rome which also declared the nullity of the IRS for lack of cause.[713] In so doing, the Tribunal took into express consideration the criteria laid down by CONSOB, in particular, the fact that the hedging funtion is expressly mentioned in the contract, that there is a correlation between the notional amount of the IRS and the debt.[714]

2.2. Spain

2.2.1. The patterns of litigation

The main patterns of litigation in Spain concerned the mis-selling of PPRs, Lehman Brothers bonds and IRS. As I mentioned, PPRs are perpetual variable income instruments with no voting rights nor shareholding that rank after subordinate debt in the case of the issuer's insolvency.[715] The main reason for the widespread distribution of PPR (more than 300,000 clients) was that these hybrid products were very efficient

[709] Compare the judgments of the German Federal Supreme Court, which held that the bank has the duty to inform the client on the negative market value of the IRS: 22 March 2011, XI ZR 33/10; 22 March 2016, XI ZR 425/14. See J. D. Jansen, *Case Note—Judgment of the Bundesgerichtshof (Federal Court of Justice of Germany) of 22 March 2011: Passion to Inform— BGH Expands Banks' Advisory Duties*' 12 German Law Journal (2011): 1504.
[710] See in this regard the Consob. Comunicazione 2.3.2009 n. 9019104.
[711] See also Trib. Milano 19 April 2011, in *Resp. civ. e prev.*, 2011, p. 735; Trib. Bari, 5 January 2012. Instead, Trib. Milano 13 February 2014 and Trib. Palermo 6 October 2015, decided that the lack of information on the MTM determines the termination of the contract.
[712] Trib. Torino, 17 January 2014; App. Torino, 22 April 2016; Trib. Milano, 7 July 2016; Trib., Treviso 26 August 2015, Trib. di Monza, 17 July 2012.
[713] Trib. Roma, 8 January 2016.
[714] See CONSOB, Direttiva 26 febbraio 1999, n. 9901391.
[715] See Chapter 4, above.

for the firms from both an accounting (they counted as liability on the balance sheet) and prudential (they could be included in the own funds) perspective.

However, the distribution of PPRs – typically through non-advised services – was often characterized by misconduct, including lack of information on the concrete risks, false information on the nature of the product (i.e. fixed, instead of variable, yield) and implicit recommendations to buy.[716] Whilst until 2008 financial firms managed to regularly and fully reimburse PPR holders, after 2008 firms encountered liquidity problems and gradually stopped making the early and the full reimbursements of the PPR amounts. As a result, the PPR's holders triggered an unprecedented wave of litigation before the Spanish Courts. Up to July 2013, around 6,400 lawsuits were brought by PPR holders against the three banks owned by the FROB (Bankia, NGC Banco, Catalunia Caxia) accounting for a total amount of approximately EUR 430 million.[717] In 491 cases out of 577 already ended up with a judgment (85%), the Spanish Courts ruled in favour of the client.[718]

Besides the litigation on Lehman Brothers' bonds, the other distinctive strand of disputes concerned the mis-selling of IRS to retail clients. What emerges from the Spanish situation is the perverse correlation between poor lending practices and mis-selling. The impressive diffusion of IRS among retail unsophisticated clients (which gave rise to more than 2.000 judgments already delivered by Spanish Courts)[719] was the result of the widespread practice of credit institutions to offer these derivatives in conjunction with mortgages with the purpose of offsetting the (expected) upward

[716] CNMV. *Annual report 2012*, p. 148.
[717] Comision de seguimento, first trimestral report, September 2013 (data updated at 19.7.2013). Spanish lower courts have already decided around 1200 cases on PPR, whereas the Tribunal Supremo has
[718] Spanish lower Courts (first and second instance) have already handed down around 1,200 judgments on PPRs and the Supreme Court delivered 451 judgments. Data available at www.poderjudicial.es/cgpj/es/Servicios/Jurisprudencia and www.aranzadi.com.
[719] See, *inter alia*, J. G. Pascual. 'La protección de consumidores y usuarios en la contratación de permuta financiera o swap' *Revista Doctrinal Aranzadi Civil-Mercantil* (2013) 9; C. Martinez Escribano. 'Delimitacion del error en los contractos de swaps, in Revista de Derecho Bancario y Bursátil' (2013) 130.

trend of the mortgage variable interest rate.[720] This practice, allowed by national law,[721] has favoured the overindebtedness of thousands of Spanish consumers and has facilitated the distribution of unsuitable financial products to retail clients.

This was because financial firms did not apply the MiFID appropriateness and suitability rules to the distribution of these derivatives, by invoking the MiFID exception of Article 19(9) that exempts firms from conducting these tests if the investment service was offered as part of a financial product already subject to other legal provisions. As I will show below, this common practice triggered four requests for preliminary rulings to the CJEU by the Tribunals of Madrid and Barcelona which asked the CJEU to determine the exact interpretation of Article 19(9) of the MiFID I and to establish whether the lack of suitability test may determine the absolute nullity of the IRS.[722] The CJEU answered to these questions in the landmark judgment in case C-604/11, *Genil GL v Bankinter*.[723] The other three references concluded with an order, either because of the settlement reached by the litigating parties,[724] or because the referring Court did not pursue the preliminary ruling proceeding after the CJEU judgment.[725]

2.2.2. Whether the private law duties are stricter than financial regulatory duties

A) Non-advised services

[720] See, in particular, F. Zunzunegui. 'Mis-selling of preferred shares to Spanish retail clients' 174.
[721] See Article 19 (2) of the Law 36/2003 allowed Banks and financial entities to offer to the mortage loan borrowers a financial product enable to cover the risk of the increase of the interest rate.
[722] See the request from the Juzgado de Primera Instancia No 12 de Madrid of 14 November 2011, Genil 48 SL, Comercial Hostelera de Grandes Vinos SL v Bankinter SA; requests from the Juzgado Mercantil de Barcelona of 30 December 2011, (ECJ) joined cases 664/11, Serveis en Impressio i Retolacio Vargas, S L v Banco Mare Nostrum and 665/11, Alfonso Carlos Amselem Almor v NCG Banco; request from the Juzgado Mercantil de Barcelona of 18 July 2011, case 381/11, Manuel Mesa Bertrán and Cristina Farrán Morenilla v Novacaixagalicia.
[723] Case C-604/11, *Genil GL v Bankinter*, ECLI:EU:C:2013:344.
[724] Case C-381/11, Manuel Mesa Bertrán, ECLI:EU:C:2012:12.
[725] Joined cases C-664/11 and C-665/11, Serveis en Impressio i Retolacio Vargas, EU:C:2013:615.

The majority of disputes concern firm' alleged failure to comply with general information duties (pre-MiFID) and with the MiFID appropriateness rule in non-advised services. It is worth recalling that the MiFID I and Commission MiFID I Directive were transposed by the Law No 47/2007, which amended the Law No 24/1988 on the securities market (Ley 24/1988 del Mercado de Valores).[726] More detailed rules on the conduct of business obligations are laid down by the Royal Decree No 217/2008.[727]

Ever since 2005, the Spanish Supreme Court has held that financial firms must adopt an higher standard of care than that imposed for ordinary day-to-day transactions.[728] In particular, according to the settled case law of the Supreme Court, even if the pre-MiFID regulatory framework did not require firms to classify clients or to conduct a suitability or appropriateness test, firms have a duty to provide clients with information on the concrete risks of the products in order to make an informed decision.[729] With regard to IRS and derivatives, the Supreme Court clarified that there is no difference between the pre- and post-MiFID regime because the information asymmetry between the retail client and the firm, requires the firm to give, even in the pre-MiFID regulatory framework, information on the characteristics of the products and its risks.[730] Therefore, firms are not required to foresee the future evolution of interest rates but to warn the client on the concrete risks of the product and to make sure that he the risks were adequate with his or her investor profile.[731]

The Supreme Court, however, dismissed the clients' claims for the avoidance of contract for the firm's breach of the MiFID's appropriatenes rules, in relation to PPRs,

[726] Ley 24/1988 del Mercado de Valores (BOE n. 181 of 29 July 1988). The LMV was implemented by the Royal Decree No 629/1993 and the Order of the Ministry of Economy of 25 October 1995, in order to transpose the ISD.
[727] Real Decreto 217/2008, de 15 de febrero (BOE n. 41 of 16 February 2008).
[728] STS, 14 November 2005 .11.2005. See recently, in the same sense, STS 20 January 2013 (RJ 2003 350 and JPI Madrid, 8/4/2013, AC\2013\963).
[729] STS, 21 July 2015, n. 3228/2015 - ECLI: ES:TS:2015:3228.
[730] STS, 1861/2017 - ECLI: ES:TS:2017:1861.
[731] STS, 7 July 2014, n. 2660/2014 - ECLI: ES:TS:2014:2660 and STS, 26 February 2015, n. 756/2015 - ECLI: ES:TS:2015:756.

when, on the basis of the concrete assessment of the case, the presumption could not apply because all the information was given to the client.[732]

B) Advised services and portfolio management

A recurrent issue in Spanish litigation concerning PPRs and IRS is whether advice was given to the client and therefore whether the firm was required to conduct the suitability test. As I mentioned, financial firms frequently distributed PPR and IRS without carrying out either a suitability or an appropriateness test. In the case of the IRS, this was justified by referring to the exemption under Article 19(9) MiFID, transposed by Article 79c of the LMV. In *Genil GL v Bankinter*, the CJEU laid down important criteria for the interpretation of this provision.

First, it held that this exception, in so far as it derogates from rules aimed at guaranteeing the protection of investors, should be interpreted strictly.[733] Second, it underlined that the investment service can be offered as part of a financial product only "if it forms an integral part of that financial product at the time it is offered to the client".[734] Third, whilst specifying that it is for the national court to decide whether the IRS was part of the other product, the CJEU clarified that some factual elements (e.g. duration of the financial instrument greater than the product), suggest that the service does not form an integral part of the financial product in question.[735] Fourth, the exception applies only if the standards applicable to the other product allow a risk assessment of the client which should encompass the investment service which forms an integral part of the financial product in question.[736] In conclusion, as Grundmann notes, this Court's interpretation means that 'in substance, the exception contained in art. 19(9) MiFID may not lead to inroads into the main goal of (individual) investor

[732] STS 1497/2017 - ECLI: ES:TS:2017:1497 and STS 1295/2017 - ECLI: ES:TS:2017:1295.
[733] Case C-604/11, *Genil GL v Bankinter*, para 39.
[734] Case C-604/11, *Genil GL v Bankinter*, para 42.
[735] Case C-604/11, *Genil GL v Bankinter*, para 44.
[736] Case C-604/11, *Genil GL v Bankinter*, para 46.

protection and this is true even in cases where the MiFID does not express this".[737]

In addition, the CJEU in answering a question on the interpretation of the notion of advice, held that the offering of an IRS is to be regarded as an investment advice under the MiFID I and the Commission MiFID I Directive if that the recommendation to subscribe to such a swap agreement is made to that client in his or her capacity as an investor, it is presented as suitable for that person or based on a consideration of the circumstances of that person and it is not made solely through distribution channels or intended for the public.[738] However, and importantly, the CJEU specified that the qualification of the service as 'investment advice' does not depend on the nature of the financial instrument to which the service relates, but "on the manner in which the financial instrument is offered to the client or potential client".[739]

The Spanish Supreme Court, following the *dicta* of the CJEU, held that to understand whether the investment service is investment advice it is necessary to conduct a concrete assessment and that it is not necessary that an advisory agreement has been concluded.[740]

C) The avoidance of contract for mistake

Just as in Italy, in the absence of an express statutory remedy, national courts granted investors remedies based on general contract law. Spanish Courts have rarely declared the absolute nullity of the contract for illegality (the breach of the mandatory rules of public order under art. 1255 c.c.) or for the lack of consent, the object or the cause of the obligation (art. 1261 c.c.).[741]

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[737] S. Grundmann. 'The Bankinter Case on MiFID Regulation and Contract Law' 274.
[738] Case C-604/11, *Genil GL v Bankinter*, para 55.
[739] Case C-604/11, *Genil GL v Bankinter*, para 51.
[740] STS, 25 February 2016, n. 610/2016 - ECLI:ES:TS:2016:610; STS, 17 June 2016, n. 2894/2016 - ECLI:ES:TS:2016:2894; STS, 30 November 2016, n. 5288/2016 - ECLI: ES:TS:2016:5288. See also, for the reference to the CJEU judgment: Audiencia Nacional, 15 July 2013, n. 3163/2013 - ECLI: ES:AN:2013:3163.
[741] See Juzgado Primera Instancia, (JPI), Hospitalet de Llobregat, 5.6.2013, n. 139. Available at http://www.rdmf.es/wp-content/uploads/2013/07/sjpi-nc2ba-4-hospitalet-de-llobregat-5-junio-

The most recurrent remedies afforded by Spanish Courts are the relative nullity for mistake (Article 1265 c.c.)[742] and termination of the contract (Article 1124 c.c.).[743]

A mistake can determine the nullity of the contract if three conditions are met.[744] First of all, the mistake must be essential, namely it must concern the subject matter of the contract. Second, the mistake must be inexcusable in the circumstances, namely it cannot be based on the client's negligence. Third, there must be a causal link between the incorrect information and the misconceived representation of the factual or legal reality behind the conclusion of the contract.[745]

A recurrent question in the case law is whether the breach of the regulatory duties can lead in itself to a mistake. In this regard, the Supreme Court has specified in several judgments that lack of suitability test, if the contract involves IRS or PPRs distributed to retail clients, does not indicate in itself the existence of the mistake but is a presumption of that mistake. In particular, in such a case the mistake is essential because it concerns regulatory duties, is causally determined by the breach of informaiton duties (*error heteroinducido*) and is inexcusable.[746] In particular, the

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2013.pdf. For instance, in a recent case, the claim for the absolute nullity on the consent was dismissed because, even though the plaintiff did not sign the contract for the purchase of PPR, her consent was proved (see JPI, O Porriño, 26.3.2013, n. 416. Available at http://www.rdmf.es/wp-content/uploads/2013/04/sjpii-nc2ba-2-o-porric3b1o-26-mar-2013.pdf). The subsequent judgments of JPI and Audiencia Provincial are available on this website.

[742] The relative nullity (annullability) affords investors restitutionary damages but the claim is subject to a four-year limitation period and the contract can be confirmed, with the agreement of the parties. The nullity of the contract may also bring about the nullity of the arbitration agreement. In favour: Audiencia Provincial (AP) Guipúzcoa, 28.11.2011, n.102/2011; against: AP Madrid, 23.4.2004 (PROV 2004, 237481.

[743] See, for a general overview M. F. Benavides. 'Participaciones preferentes: aproximación al problema y primeras respuestas de la jurisprudencia civil' Revista CESCO de Derecho de Consumo (2012): 17 ss.; C. Guerrero. 'Las acciones y participaciones preferentes: acciones judiciales y estrategias de defensa' 6 Revista Aranzadi Doctrinal (2012).

[744] See for a detailed analysis of the concept of mistake in the Spanish case-law on PPR, A. Carrasco Perera. ' Aventuras, inventos y mixtificationes en eld debate relative a las participationes preferentes' 133 Revista de Derecho Bancario y Bursatil (2014): 39.

[745] JPI Terragona, 8.7.2013; AP Huelva, 28.10.2013; AP Madrid, 21.3.2011 (AC 2011, 1056); AP Barcelona, 22.3.2012 (AC 2012, 785) See AP Palma de Mallorca, 9.1.2011, n. 234; AP Murcia, 1.4.2011, n. 105; AP Pontevedra, 25.4.2012, n. 324; JPI, 10.7.2012; AP Madrid, 12.11.2012, n. 555; AP Lugo, 31.10.2012, n. 580.

[746] STS, 20 January 2013, n. 354/2014 - ECLI: ES:TS:2014:354; STS, 10 September 2014, n. 4339/2014 - ECLI: ES:TS:2014:4339; y 769/2014; STS, 11 March 2016, n. 985/2016 - ECLI: ES:TS:2016:985.

Supreme Court reiterated that in financial law, unlike in general contract law, the omission of information determines the excusable character of the mistake because regulatory duties, derived from EU law, indicate the the legal system intends to grant enhanced protection to the client.[747] The Supreme Court held, in relation to the mis-selling of PPRs, that a mistake is excusable even if the client could have checked himself the information made availbale by the CNMV because the firm has an active obligation to inform and the client has a legitimate expectation to receive correct information.[748] Importantly, the fact that the retail client is a enterprise does mean that the mistake is inexcusable because, the board of directors of that enterprise cannot be required to have specific knowledge of complex financial products.[749]

If the client is sophisticated, Spanish courts undetake a concrete assessment on the excusability of the mistake. In 2012 the Supreme Court overturned the judgmet of the Court of Appeal, which had declared the nullity of the IRS, deciding that the purpose of the retail sophisticated client was to speculate and not to hedge and therefore the investor was meant to assume the risk of losing its investment.[750] However, in some recent judgments the Supreme Court decided that the mistake can be excusable, based on the circumstances of the case, even if the client is experienced. [751]

D) The liability for damages and termination of contract

In numerous cases concerning Lehman Brothers products,[752] Spanish courts have awarded contract damages to the client (Article 110 c.c.)[753] or terminated the contract

[747] STS, 17 June 2016, n. 2894/2016 - ECLI:ES:TS:2016:2894.
[748] STS, 16 September 2015, n. 4004/2015 - ECLI: ES:TS:2015:4004.
[749] STS, 12 May 2017, n. 1861/2017 - ECLI:ES:TS:2017:1861.
[750] STS, 21 November 2012, n. 843/2012 - ECLI: ES:TS:2012:7843. See for a comment C. Martinez Escribano. 'Delimitacion de l'error en los contratos de swap', 130 Revista de Derecho Bancario y Bursátil (2013): 293 ss. See also STS, 17 February 2014, n. 1353/2014 - ECLI:ES:TS:2014:1353.
[751] See however STS, 11 May 2017, n. 1854/2017 - ECLI: ES:TS:2017:1854 and STS, 20 January 2014, n. 354/2014 - ECLI:ES:TS:2014:354.
[752] See, in particular, Y. B. Sainz de Baranda. 'El caso Lehman Brothers en la jurisprudencia española. Alcance de la responsabilidad de las entidades bancarias y de las empresas de servicios de inversión', 128 Revista de Derecho Bancario y Bursátil (2012): 211.; A. Carrasco Perera. 'Lehman Brothers: que cada palo aguante su vela' Actualidad Jurídica Aranzadi, (2012) 834.
[753] STS, 13 July 2015, n. 3221/2015 - ECLI:ES:TS:2015:3221.

for sufficient serious breach (art. 1124 c.c.) [754] It is therefore clear in the case law that conduct of business rules are incorporated into contract and cannot be derogated by the parties. The written and signed declaration that the suitability test was conducted, does not disclaim the firm from liability under private law.[755] Likewise in Italy, the unpredictability of the default was one of the most important argument used by Spanish Courts to dismiss the investors' claims seeking the avoidance or the termination of the contract. In some cases, however, the claims were dismissed because the contract was concluded more than one year before Lehman's collapse and the firm could not be required to inform the client about Lehman's risks. [756]In others, the Supreme Court decided that the firms have a duty to inform the client, not about the unforeseeable even of the bankruptcy but about its risks.[757]

2.3. France

2.3.1. The Patterns of litigation

Unlike Italy and Spain, France has not experienced mass mis-selling cases; financial litigation in France has mostly focused on the breach of conduct of business rules in transactions involving financial derivatives. In particular, a recurrent pattern of litigation concerns the alleged breach of the 'obligation de couverture' with regard to

[754] STS, 9 September 2014, n. 3812/2014 - ECLI:ES:TS:2014:3812. See also : AP Cantabria, 9.1.2014, n. 3 ; AP Asturias, 1.10.2013, n. 249; AP Las Palmas, 18.3.2013, n. 82; AP Asturias, 26.9.2011, n. 431/2011; AP Islas Baleares, 16.2.2012, n. 82; AP Islas Baleares, 17.7.2013, n. 291/2013; JPI Madrid, 9.6.2010, n. 1340; JPI Badajoz, 24.11.2009, n. 207.

[755] STS, 13 July 2015, n. 3221/2015 - ECLI:ES:TS:2015:3221.

[756] STS, 18 April 2013, n. STS 3016/2013 - ECLI:ES:TS:2013:3016 See, also JPI Palma de Mallorca, 29.9.2010, n. 22; AP Zaragoza, 6.7.2011, n. 439; AP Valladolid, 14.10.2013, n. 240; AP Madrid, 24.4.2012, n. 167; AP Madrid, 28.5.2012, n. 323; AP Zaragoza, 24.1.2012, n. 27; AP Burgos, 4.3.2013, n. 58; AP Zaragoza, 30.3.2012, n. 46; AP Madrid, 16.12.2012, n. 31; AP Granada,15.7.2011, n. 333; AP Madrid, 16.12.2012, n. 31; AP Granada, 15.7.2011, n. 333; AP Madrid, 10.12.2012, n. 538; AP Madrid, 15.4.2013, n. 119.

[757] See also STS, 16 September 2015, n. 4004/2015 - ECLI: ES:TS:2015:4004 (with regard to bonds issued by the Landbanski Island); STS, 18 April 2013, n. 2589/2013 - ECLI:ES:TS:2013:2589 (the Supreme Court also held that national law must be interpreted in light of the literal meaning and the purpose of the MiFID I).

short-selling transactions (*Ordres de Service à Règlements livraisons Différés*).[758] In short-selling, a party sells securities that he or she has borrowed or not borrowed (naked short-selling) with the purpose of repurchasing in the near future on the assumption that their price will fall. Short-selling is therefore a typical speculative transaction because the seller expects (and speculates on the likelihood) that the securities' price will fall. Whilst this practice can foster market efficiency, it can also seriously damage the stability of markets and the protection of the investor. One of the regulatory responses to these risks is to require the seller to provide adequate colleral in order to reduce the risk of unforeseeable losses.

In France, since 2000, short-selling has been governed by the *service de règlement ou de livraison différé* ("SRD"),[759] managed by the Paris Stock Exchange, which receives and transmits orders to buy or sell financial instruments on financial markets and ensures that the seller provides adequate collateral or margin (*couverture*) to hedge its potential losses. The Decree of 30 October 1961 required financial firm to post a collateral to prevent the default risk of one of the parties involved in the transaction.[760] In particular, Article 516-2 of the AMF Regulation requires the financial firm which has received the order to require the investor to establish coverage that amounts at least at the 20% of the total sum invested.[761] Second, if the client does not provide sufficient coverage, the firm must require the client to regularize the uncovered position and, if not regularized, it shall liquidate its position.[762] The AMF Regulation further provides several organizational rules that the financial firms must respect when executing these

[758] See, in particular, M. Storck. 'Disproportion du montant de la couverture avec le risque spéculatif' 4 Revue de Droit bancaire et financier (2010), comm. 162.
[759] The SRD replaced the le sistem de règlement mensuel,
[760] nous savons que le décret du 7 octobre 1890, qui a été abrogé par la loi nG 88-70 du 22 janvier 1988 et le Règlement général du Conseil des Valeurs de Bourse, ont été remplacés par de nouvelles dispositions qui ont été insérées dans le Règlement général du Conseil des Marchés Financiers, qui sont applicables à tous les prestataires de services d'investissement et définissent les principes généraux de couvertures sur les marchés réglementés ainsi que les possibilités de liquidation d'office.
See M. Storck, La responsabilité encourue pour le défaut d'exigence de couverture sur le marché à terme, RTD Com. 2001, p. 175 and H. de Vauplane. 'La couverture des opérations en bourse : une sûreté hybride', Revue Droit Bancaire (1998): 197.
[761] Since the decree of 7 octobre 1890 financial intermediaries have been allowed to establish a coverage in order to prevent the default risk of one of the parties involved in the transaction. Since the decree of the 30 octobre 1961 this has become a mandatory requirement
[762] Articles 517-7, 518-3, al. 3, AMF Regulation.

orders, such as automatic systems to certify the orders and automatic blockage of orders if the coverage is not sufficient (Article 321-62). Litigation is typically triggered by the unilateral decision of the financial firm to liquidate the client's exposure, in the absence of adequate information.

Another, more recent pattern of litigation, concerns financial derivatives and, particularly, IRS. Unlike Italy, however, litigation does not concern issues regardng the validity of IRS contract terms or the design of these complex financial instruments but, like in Spain, rather the lack of pre-contractual information on the risks and rewards of the IRS. Both the litigation on short-selling and IRS concerns the question of whether the breach of these obligations determines a breach of the private law duties to inform and whether it gives rise to private law remedies.

2.3.2. Whether the private law duties are stricter than financial regulatory duties

A) The óbligation de renseignement, mise en garde and de conseil

A recurrent issue examined in the case law is whether the duty to inform (*óbligation de renseignement*), to warn (*óbligation mise en garde*) and to advise (*óbligation de conseil*), elaborated by the Supreme Court in general private law matters,[763] apply to financial firms providing financial services and instruments to clients. These three distinctive information duties have different scope and *intensity*. The *óbligation de* renseignement is an objective, neutral obligation which aims at informing the other party on the nature and object of the contract. The *obligation de mise en garde* consists of a negative obligation in so far as it aims at warning the other party about a negative aspect of the transaction. The *obligation de conseil,* in contrast, is a positive obligation that requires the party to disclose the fundamentl elements of the transactions,

[763] See, in particular, M. Fabre-Magnan. *De l'obligation d'information dans les contrats*, LGDJ, coll. Bibl. dr. privé, 1992, n° 467 ss. With regard to the financial services, see M. Storck. '*Le particularisme de l'obligation d'information en matière de gestion d'instruments financiers*' Revue trimestrielle de droit commercial (2006) : 157.

including risks and rewards.[764] National courts 'shape' the duties to inform, warn and advice on the basis of the nature of the transaction (speculative or non-speculative) and the type of client (retail or non-retail).

There is no precise definition of 'speculative transaction' in the case law. The French courts follow a case-by-case approach to identify particular financial products whose marketing and offering requires a particular degree of attention by providers. In this regard, speculative transactions include short-selling practices,[765] and options.[766] Instead, IRS concluded for hedging purposes,[767] as well as the purchase of units in UCITS[768] or a life insurance contract,[769] are not regarded as speculative transactions.

Similarly, French courts categorize clients (retail or non-retail) based on the circumstances of the case. In order to understand the client's profile, courts undertake a concrete and case-by-case analysis that considers all the factual circumstances of the case. For example, case law considers that a client who has worked in a stock exchange[770] or insurance company[771] or for an engineering company[772] has sufficient background to understand the risks of financial transactions but a lawyer or expert in the field of financial regulation is not deemed to be a sophisticated client.[773]

Duty to inform (*reinsegnement*)

The financial firm has a general duty to inform the client about the essential feature of

[764] See, in particular, J. Attard. '*Du champ d'application du devoir de conseil du banquier*' Revue trimestrielle de droit commercial (2011): 11 ss.
[765] Cass., Com. 12 February 2008, D. 2008. 689, obs. X. Delpech.
[766] Cass., Com. 23 February 1993, D. 1993. 424, note I. Najjar .
[767] cass., Com. 19 June 2007, Banque et Droit juill.-août 2007. 28, obs. H. de Vauplane
[768] Cass., Com. 19 September 2006, JCP 2006. II. 10201; Cass., Com. 12 October 2010, n° 09-16.961, D. 2011. 472.
[769] Cass., Com. 20 March 2007, JCP E 2007. 1819.
[770] Cour d'Appel de Paris, 26 April 2000, *Moritz c/ SA Oppenheim-Pierson-Melendes*.
[771] Cour d'Appel de Paris, 29 October 1999, *SA Wargny c/ Moreau*.
[772] Cass., Com. 7 April 1998, *Savour club c/ BFCE et Cie AGF,* RTD com. 1998 p. 637.
[773] Cass., Com., 26 March 2008, *Bull.* 2008, IV, no 69, pourvoi no 07-11.554.

the financial instrument[774] and to seek the necessary information on the financial situation of the client.[775] This general duty, therefore, applies to both speculative and non-speculative transactions and to both retail and non-retail clients.[776] The French Supreme Court, likewise the Italian and the Spanish Supreme Courts has also stressed that this duty shall be determined by the specific regulatory requirements imposed, in particular, by Article 533 of the CMF with regard to the duty of the firm to provide information that must be clear, correct, and in no way misleading and must be tailored on the specific characterstics of the financial instruments and the client.[777] The Supreme Court went so far as to hold that the firm does not meet the duty to inform if it merely delivers the client documentation provided for by the supervisory authority without giving other specific information.[778]

Duty to warn (*mise en garde*)

The 'duty to warn' is stricter and more intense than the 'duty to inform' because it requires the firm to warn clients about the potential risks of financial transactions. In 1974, the Supreme Court extended this duty to speculative transactions, regardless of the contractual relationship with the client (e.g. mandate, execution orders).[779] In 2008 the Supreme Court held that the firm's duty to ask the client about his or her financial situation and experience under Article 533-4(4) of the CMF shall apply notwithstanding of the contractual relationships with the client ('quelles que soient ses relations contractuelles avec son client') and therefore also in the context of execution

[774] Cass., Com., 20 March 2007, pourvoi no 05-21.922.
[775] Cass., Com., 12 February 2008, *Bull.* 2008, IV, no 31, pourvoi no 06-20.835 ; Cass., Com., 5 May 2009, pourvoi no 08-14.983; Cass., Com., 13 Octobre 2009, pourvois no 08-14.256, 08-14.257, 08-14.258 et 08-15.363, 08-14.259, 08-14.260 et 08-15.364; Cass., Com., 2 February 2010, pourvoi no 08-20.150.
[776] See Cour de Cassation.Rapport Annuel 2010, a Documentation française. Paris, 2011, p. 130.
[777] Cass., Com., 16 June 2009, *Bull.* 2009, IV, no 78, pourvoi no 08-11.618 ; Cass., Com., 7 July 2009, pourvoi no 08-18.194 (market risk) and Cass., Com., 23 June 2009, pourvoi no 08-15.567 (loss of capital).
[778] Cass. Com., 24 June 2008, n°06-21.798) (with regard to a notice issued by Commission des opérations de bourse – replaced in 2003 by the AMF – on collective investment funds).
[779] Cass., Com., 28 October 1974, *Bull.* 1974, IV, no 264, pourvoi no 72-14.397; Cass., Com., 5 Novembre 1991, *Bull.* 1991, no 327, pourvoi no 89-18.005 (arret Buon); Cass., Com., 27 Janvier 1998, *Bull.* 1998, IV, no 41, pourvoi no 93-18.672 ; Cass., Com., 13 July 2010, pourvoi no 09-69.638.
64.

only services. Notably, in the case at stake, the Supreme Court held that the contractual documentation was not sufficient to inform adequately the client about the risks of the transaction.[780] In a recent important judgment, the Supreme Court affirmed that the duty to warn the client on the complexity and high risks (*complexité et le risque élevé*) of the transaction shall be respected also in execution only transactions in accordance with Article 533(2) of the CMF.[781]

Second, the duty to warn does not apply to sophisticated clients (*opérateur averti*) who are supposed to have sufficient information about the risks of the transaction.[782] With regard to short-selling transactions, the duty to warn's scope, does not include all the general risks of the financial instruments but on the specific risk that the uncovered position of the investor is liquidated. With regard to transactions in IRS, the duty to warn requires the financial firm to inform the client about the hidden/implicit costs of the swap. [783]

Duty to advise (*conseil*)

According to the settled case law, financial firms do not have a general duty to advise (*conseil*); this duty can be enforced only if its is expressly laid down by law or the contract.[784] In this vein, the Supreme Court decided that the financial firm does not have the duty to disclose the profit gained from the interest rate swap concluded with

[780] Cass., Com., 4 November 2008, *Bull*. 2008, IV, n° 185, pourvoi n° 07-21.481. See also Cass., Com., 12 February 2008, n° 06-20.835
[781] Cass., Com., 16 February 2016, n° 14-25.104.
[782] Cass., Com., 14 June 2005, pourvoi no 03-15.379 (risque particulier présenté par une vente à terme de devises, alors que la tendance était à la hausse).
[783] TGI Paris, 9e ch., 3e sect. , 29 janvier 2015, n° 11/09601, *Syndicat Intercommunal pour la Destruction des Résidus Urbains (SIDRU) c/ DEPFA Bank Public Limited Company enseigne « DEPFA Bank »*), commented by M. Storck. ' Défaut de mise en garde du client et perte de chance de ne pas contracter un contrat de swap aligné sur la différence de parité de change entre le dollar et le franc suisse' Revue trimestrielle de droit commercial (2015): 129.
[784] See Cass., Com., 14 January 2016, n. 14-27.001 (the Supreme Court rejected the client's claim for breach of duty of conseil because no contract of mandate was concluded). See also A. Prum. 'Le dilemme de la jurisprudence: protege', Droit & Patrimonie (2015): 85.

the client.[785] The firm, however, has the duty not to intentionally advise clients purchase financial instruments that are not suitable for the investor's profile.[786]

In this respect, French courts have developed, even before the entry into force of the MiFID I, some criteria to establish when, in the absence of a contract clause, advice should be given to the client (i) the investor profile (*compétence professionnelle*); (ii) the nature of the transaction (*nature des opérations réalisées*); (iii) the financial expertise and the frequency of the transactions (*la connaissance des instruments financiers et le volume des opérations*). The frequent nature of the financial transactions does not indicate *per se* that the client is fully aware of the risks[787] but it is a factor that could provide evidence of the client's expertise, together with the expertise acquirerd by the client during the contractual relationship.[788]

B) Advised and non advised services

Whilst the nature of transaction and the type of clients play an important role in the case law, less attention is paid to the type of service provided for by the financial firm (execution orders, advice or portfolio management). The overwhelming majority of financial disputes concerns the alleged breach of duty to warn in execution only services, i.e. execution of the client's order to buy/to sell securities on short-selling markets. As I showed above, the Supreme Court has developed the rule, based on general private law, that in these transactions the financial firm has a duty to warn the client about the potential risks and rewards but does not have a duty to advice, unless is expressly provided for in the contract.

In portfolio management transactions, instead, the Supreme Court requires the

[785] See Cass., Com., 17 March 2015 n. 13-25.142.
[786] Cass., Com., 7 avril 2009, n. 08-10.059.
[787] CA Paris, 26 nov. 1999, *Chaumet c/ SA Wargny*, RD bancaire et financier 2000, n° 79.
[788] Cass. com., 6 December 2005, Juris-Data n° 031396.

financial firm to hold a higher standard of skill and care under Article L. 533-4 CMF.[789] The Supreme Court applies to the portfolio management the rules of the contract of mandate and therefore considers this contract as involving an obligation de moyen, not de resultat, but requires the financial firm has a general duty to supervise the client (l'obligation générale de vigilance) not only before the conclusion of the contract but also during its performance, by disclosing all the circumstances that might change the initial relationship and therefore have an impact on the investment.[790]

2.3.3. Private law remedies for the breach of conduct of business rules

A) The avoidance of contracts for mistake or fraud

Unlike in Italy and Spain, in France national courts have rarely declared the contracts null and void for the breach of information duties. In recent judgments, French courts have dismissed the claims for the absolute nullity of an IRS on the ground of mistake and fraud. In a recent case, a client claimed that the IRS should be annulled on the ground of the IRS on the ground of mistake (Article 1110 c.c.) and the compensation for contractual liability. However, the Tribunal of Paris rejected both claims,[791] by arguing that the fact that the swap was subject to risk could not be considered as a false representation of facts (mistake) and that the financial firmdid not breach an information duty, taking also into account the fact that the firm negotiated the IRS on his or her own behalf, without advice.

In another case, the Supreme Court, with regard to a IRS entered concluded by a corporation, specified the relevance of fraud in disputes regarding these complex financial instruments. The plaintiff claimed, in essence, that the financial firm intentionally disclosed the false statement that interest rates would have risen whilst,

[789] Cass., Com., 5 May 2009, pourvoi n. 08-14.983, et 23 juin 2009, n. 07-22.032.
[790] Cass. com., 8 November 2005, Juris-Data n. 030874.
[791] TGI Paris, 9e ch., 3e sect., 29 January 2015, n. 11/09601, *Syndicat Intercommunal pour la Destruction des Résidus Urbains (SIDRU) c/ DEPFA Bank Public Limited Company enseigne « DEPFA Bank »*).

in truth it knew that they would have remained low, thus negatively affecting the client's profit. The plaintiff claimed that had the correct information be given to him, he or she would not have concluded the IRS.

The Supreme Court held that a fraud under Article 1116 c.c. can be committed also by omitting information (*simple silence*). However, the Supreme Court concluded that, in the concrete case, the financial firm could not know, before the conclusion of the contract, that the interest rates would have been as lowas they were.[792] For the same reason, the Supreme Court rejected also the claim for absolute nullity for lack of cause (Article 1131 c.c.) because there was no evidence that the financial firm knew in advance the fact that the interest rate would have been low, thus frustrating the 'aleatory nature' of the contract. Interestingly, unlike Italian courts, the Supreme Court did not investigate further whether this 'alea' was rationale, i.e. whether contractual terms stroke a fair balance between risks and rewards of the IRS. Finally, the Supreme Court rejected the client's claim for contractual liability of the financial firm because the financial firm did not breach any information duties.

In another case regarding an IRS, concluded by a corporation, the Supreme Court rejected the claims for the annullment of contract on the ground of vice of consent but held the financial firm liable for breach of contract under Article 1147 c.c because of the breach of duty to warn the client, in particular, about the renegotiation of the IRS.[793] However, the Supreme Court held that the financial firm, which acts in his or her own behalf, does not have the duty to inform its counterparty (the client) about the profits (and the methodology to calculate them) that it would make from the transaction. In this regard, therefore, the approach of French courts seems to be stricter than that of Italian, Spanish and German courts which have reiterated that, even if the financial firm acts on its own behalf, it has the duty to inform the client about the profits/rewards of the IRS.

[792] Cass., Com. 2 juin 2015, n. 14-18.999. See also Cass., Com., 11 March 2014, n. 12-29.506 (the Supreme Court rejected the claim for the annullment of the contract for fraud because of lack of fraud in the concrete case).
[793] Com., 17 March 2015, n. 13-25.142.3

B) The liability for damages and termination of contracts

The traditional view of French Courts was that the breach of the duty to provide collateral in short-selling transactions this conduct of business rules does not give rise to private law remedies because these rules only aim to protect the financial intermediary[794] or the stability and security of financial markets[795] but not to protect clients.[796]However, in 2008 the Supreme Court overruled this consolidated case law. [797] In the case at stake the client purchased several speculative financial instruments on the SRD. After having warned the client that his or her portfolio had a negative value, the financial firm liquidated his or her position. The Tribunal and Court of Appeal dismissed the liability clam of the client, by holding that he or she client cannot allege the breach of the financial firm duty to require a collateral before execution of the order because the duty to provide collateral aims to protect the stability of markets and not the protection of the client.

The Supreme Court overturned the judgment of the Court of Appeal and decided that the financial firm's failure to inform the client and require them to provide adequate coverage against exposure was a breach of Article 533-4 CMF and that these provisions not only aim to protect the effiency and stability of the financial system but also the clients who send buy/sell orders to the financial firm.[798] Therefore, the Supreme Court decided that the breach of regulatory duties is in itself a breach of contract and thus acknowledged the contractual nature of conduct of business rules.[799]

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[794] Cass., Com., 2 December 1997, n. 95-17.594, *Bull*. 1997, IV, no 314.
[795] Cass., Com., 8 July 2003, n. 00-18.941, *Bull*. 2003, IV, no 118.
[796] Cass., comm., 8 July 2003, n. 00-18.941 and Cass., Com., 14 December 2004, *n.* 02-13.638. For the opposite view, in literature, see M. Storck. 'La responsabilité encourue pour le défaut d'exigence de couverture sur le marché à terme', D. 1992, chr. p. 71 et s. et RTD Com. 2001, p. 175 ; H. de Vauplane. 'La couverture des opérations en bourse : une sûreté hybride', 197.
[797] Cass., Com., 14 January 2003, n° 00-12.331 (arret Borja already said that the breach of this duty can give rise to private law remedies).
[798] Cass., Com., 26 February 2008, *Bull*. 2008, IV, n° 42, pourvoi n. 07-10.761 and Cass., Com., 1 July 2008, pourvoi n. 07-16.461.
[799] See, in this regard, X. Delpech. 'Obligation de couverture en matière d'opérations financières : revirement de jurisprudence', Recueil Dalloz (2008): 778 who considers these judgments as 'arrêts « politiques »' because the Supreme Court aims to influence the behaviour of certain categories of market

This *revirement* has been further consolidated by the subsequent case law of the Supreme Court.[800] In recent judgments, the Supreme Court has also clarified thateven if the financial firm has the power to require higher collateral than that provided for by the AMF Regulation (Article 516-4), the amount of collateral has to be proportionate to the risks of the transactions[801] and that the financial firm's failure to require the client to provide collateral renders it liable for the aggraviation of the loss suffered by the client as a result of this breach of information.[802]

C) The causation in liability claims

In general contract law, the contracting party with the duty to inform, warn and advise shall prove compliance with this duty.[803] The financial firm has to show that the client was 'fully aware' (*parfaitement conscient*) of the potential risks and losses of the transactions.[804] The client has to prove the causal link between the breach of duty and the loss but he or she does not need to prove the negligence of the financial firm.[805] Despite the absence of an express legislative provision in financial services, the Supreme Court has extended this principle also in litigation concerning the breach of regulatory duties laid down in the CMF and AMF Regulation.

D) The quantification of damages

In a case where the client has alleged that the financial firm should have liquidated the client's position, even in the absence of collateral, the Supreme Court held that even

participants. See Cour de Cassation, Annual Report. 126 considers the Article 533(4)) gives rise to rise to rights *in persona* of contractual nature by virtue of Artilce 1134 c.c.

[800] Cass., Com., 4 November 2008, n. 07-21.481, *Bull.* 2008, IV, no 185; Cass., Com., 13 October 2009, n. 08-13.878 ; Cass., Com., 24 November 2009, n. 08-13.295.

[801] Cass. com., 18 May 2010, n. 09-67.102, which decided, overruling the Court of Appeal judgment, that the collateral amounting to 150% of the value of securities is not proportionate. See M. Storck. '*Disproportion du montant de la couverture avec le risque spéculatif' 4* Revue de Droit bancaire et financier (2012), comm. 162.

[802] Cass., Com., 22 May 2012, n. 11-17.936.

[803] Cass., Civ., 25 February 1997, n. 94-19685 ; Cass., Civ., 15 May 2002, n° 99-21521.

[804] Cour de Cassation, Rapport Annuel 2004, 2005, p. 263.

[805] Cass., Com., 4 February 2014, n. 13-10-630 (with regard to the breach of duty to advice in portfolio management services).

though the retail client failed negligently to provide collateral this does not discharge, even partially, the financial firm from its civil liability vis-à-vis the client.[806] The contributory negligence of the client – when the client is an unsophisticated retail investor[807] – therefore, cannot reduce the amount of recoverable damage.[808] This view relies upon the idea that the financial firm's duty to require colleteral and liquidate exposures is a mandatory duty of public policy (*ordre public*) that shall be respected notwithstanding the client's opposition or failure to provide sufficient collateral.

According to the settled case law of French courts, the recoverable damage resulting from the financial firm's breach of conduct of business rules is not the total amount of the value of the security but rather to the loss of chance to invest the money in less risky financial instruments.[809] This principle follows from the qualification of the duty to conduct of financial firm as *obligation de moyens*,[810] which is renforced by specific regulatory requirements,[811] but cannot be equated to an *obligation de resultat*. In addition to the loss of chance, the client can also recover the non-pecuniary damages (*préjudice moral*) when the amount of the loss is considerable and gave rise to serious financial difficulties for the client.[812]

2.4. The UK

2.4.1. Patterns of litigation

[806] Cass., Com., 26 June 2012, n. 11-11.450. See also Cass., Com., 26 March 2013, n. 12-13.631; Cass., Com., 9 July 2013, n. 12-20.691
[807] See, instead, Cass., Com., 14 December 2004, n. 02-13.638, which held that a non-retail sophisticated client cannot invoke the failure to inform to discard his fault.
[808] See Cour de Cassation. Rapport Annuel 2013, 2014, p. 409.
[809] Cass., Com., 10 December 1996, *n.* 94-16.082 and Cass., Com., 15 September 2009, n. 08-14.398; Cass., Com., 9 March 2010, n° 08-21.547.
[810] CA Paris, 23 March 2006, Médikéo c/ BNP Paribas : Bull. Joly Bourse, mai-juin 2006, note L. Ruet, p. 335.
[811] CA Paris, 28 janv. 2000, SA CEJIBE et a. c/ SA EFI et a. : RTD com., 2000, p. 399, note N. Rontchevsky
[812] Cass., Com., 4 February 2014, n. 13-10-360, commented by X. Delpech, Responsabilité du prestataire de services d'investissement et préjudice réparable.

Before the global financial crisis, financial litigation in the UK was mostly centred on the mis-selling of insurance or pension funds or complex financial products (i.e. short-term Russian Treasury Bills known as GKOs)[813] to sophisticated clients. In these disputes, litigated under the pre-FSMA 2000 regime, the main legal question at stake was whether common law duties are co-extensive to regulatory duties and whether their breach can give rise, besides to the statutory liability, to a concurrent liability of the financial firm at common law.[814] Another recurrent legal issue concerned the question whether regulatory duties can be regarded as contract terms by way of incorporation as well as whether financial firms can disclaim liability for negligent advice, whether a duty of care under tort law can be imposed to the financial firm in this situation. After the global financial crisis, financial disputes that arose out of the mis-selling of Lehman Brothers products and interest rate swaps to sophisticated retail clients, concerned the interpretation of the COBS rules that implemented the MiFID I in the UK.

2.4.2. Whether national private law is stricter than EU conduct regulation

The most important issue arises whether the UK Courts can impose on financial firms, under general common law stricter duties and remedies than that provided for by financial regulation.

A) Pre-FSMA 2000

Before the entry into force of the FSMA 2000, English Courts have decided that, in advisory relationships, the financial firms owe a duty of care, under common law, to the client. In *Gorham v British Telecommunications plc*, the Court of Appeal decided

[813] This litigation arose out of the 1998 default of the Russian Federation and the consequent re-structuring of its debt, issued, *inter alia*, in the form of GKO. See *Diamantides v JP Morgan* [2005] EWCA Civ 1612; *Peekay Intermark Limited v Australia & New Zealand Banking Group* [2006] EWCA Civ 386.

[814] See in particular Jackson and Powell on Professional Liability, p. 1090 and K. Alexander. 'Bank Civil Liability for Mis-selling and Advice' in D. Busch, C. Van Dam (eds.). A Bank's Duty of Care, Oxford, Hart Publishing, 2017, p. 253.

that, despite the absence of an express provision in the relevant regulatory framework[815] an insurance company, when giving advice to its client, owes a duty of care also to the potential beneficiaries. Importantly, the Court of Appeal held that the lack of an express regulatory or statutory provision does not 'eliminate the power of courts to decide whether a duty of care arises in a particular situation [and even if] courts can be expected to attach considerable weight to the content of codes drafted in these circumstances [they] are not excluded from making their own assessment of a situation.'[816]

Similarly, in three judgments concerning transactions governed by the pre-FSMA 2000 regime, namely the FIMBRA and IMRO rules, which included rules broadly similar to the MiFID-derived fair treatment and suitability rules,[817] the High Court decided that financial firms owe a duty of care at common law when giving investment advice to retail clients. In particular, in *Loosemore v. Financial Concepts,* where a retail client alleged the firm breach of the statutory duty and negligence for the mis-selling of a pension fund, the Judge held that "the skill and care to be expected [from] him would ordinarily include compliance with the [conduct of business] rules".[818] In *Seymour v Caroline Ockwell & Co.,* in which two retail clients claimed damages for the breach of statutory duty and duty of care for negligent advice in relation to the purchase of funds's units, the Judge held that "whilst the ambit of the duty of care owed by a financial adviser at common law is not necessarily co-extensive with the duties owed by that adviser under the applicable regulatory regime, the regulations afford strong evidence as to what is expected of a competent adviser in most situations".[819] Similarly, in *Shore v Sedgwick Financial Services Ltd,* where the investor claimed damages for the breach of the SIB Principles and IMRO rules in relation to the purchase of a pension fund, the Judge held that "the skill and care to be expected of a reasonably competent financial adviser ordinarily includes compliance with the relevant regulatory rules […]

[815] Paragraph 8(1) of the LAUTRO code of conduct provides laid down a suitability rule.

[816] *Gorham and others v British Telecommunications Limited Plc* [2000] 1 WLR 2129, 2141.
[817] See FIMBRA r.28.3 (Good communication) and FIMBRA r.29.5 (Suitable recommendations).
[818] *Loosemore v Financial Concepts* [2001] Lloyd's Rep. P.N. 235, para 241.
[819] *Seymour v Caroline Ockwell & Co.* [2005] EWHC 1137 (QB) para 76.

and "the regulations afford strong evidence as to what is expected of a competent adviser in most situations[…]".[820]

B) FSMA 2000

Whilst the examined case law indicates that that regulatory standards inform the duty of care owed by financial advisers under common law,[821] subsequent case law, decided under the new regime of the COB rules, under the FSMA 2000, is less clear as to whether firms owe a duty of care when providing services to their clients.

The COB Rules

The most important case decided under the COB rules is *Rubenstein v HSBC Bank plc*.[822] In 2005, a high net worth investor claimed that the bank gave negligent advice in relation to the purchase of a insurance-related financial instrument. The High Court found that the firm breached several COB rules, including the suitability rule, and by expressly referring to *Loosemoore v Financial Concepts* held that "the skill and care to be expected of a financial adviser would ordinarily include compliance with the rules of the regulator and therefore, in an advisory relationship the scope of the duty which Mr Marsden owed to Mr Rubenstein in contract and in tort embraced the relevant requirements of COB, in particular as to the suitability of the product he or she was recommending him".[823] However, whilst the Judge found that the bank gave negligent advice and breached regulatory duties, he found that the loss was too remote because it was not caused by the bank's conduct but by the "extraordinary and unprecedented financial turmoil" caused by the Lehman Brothers collapse.[824] The Court of Appeal,

[820] *Shore v Sedgwick Financial Services Ltd* [2007] EWHC 2509 (QB), para 161.
[821] See O. O. Cherednychenko. Fundamental Rights, Contract Law and the Protection of the Weaker Party, Munchen: Sellier, 2007, p. 389.
[822] *Rubenstein v HSBC Bank plc* [2011] EWHC 2304 (QB).
[823] *Rubenstein v HSBC Bank plc*, para 87.
[824] *Rubenstein v HSBC Bank plc*, para 116 (only nominal damages were awarded).

which decided that the loss was recoverable,[825] reiterated that "where the COB rules apply to investment advice provided to a private person, the applicable principles in contract and/or tort will be guided by the focus and purpose of the statutory provisions".[826]

However, in *Green and Rowley v Royal Bank of Scotland plc*., the UK courts followed a different path.[827] The claimants, two retail clients working in the field of real estate, entered into the interest rate swap to hedge against their existing loan liabilities to the bank. Following the losses suffered October 2008 and March 2009, due to the sharp decline of the base rate, the two clients sought damages for the breach of statutory duty (COB rules 2.1.3 and 5.4.3), negligent mis-statement and negligent advice. Having dismissed the statutory claim because this cause of action was time-barred, the Judge dismissed also the other claims based on common law. The Judge found, on the basis of the facts of the case, that advice was not given[828] and therefore concluded that the financial firm did not owe a duty of care to give advice to the client. In this respect, the Judge distinguished this case from with *Loosemore v Financial Concepts*, and *Rubenstein* because in these cases advice was given and the question was rather whether the duty of care could include some of the advisory provisions within the regulatory duties.[829]

The Court of Appeal, by upholding the judgment and the reasoning of the High Court, [830] firmly rejected the Appellant's view that the mere existence of the COB Rules gives rise to a co-extensive duty of care at common law by holding that granting a common law cause of action to those who do not qualify as private persons under Section 150 FSMA would be 'an invitation to the court to drive a coach and horses through the

[825] *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184 paragraph 123-124. The Court of Appeal awarded £7,195.23 in compensation.
[826] *Rubenstein v HSBC Bank plc*, para 46.
[827] *Green and Rowley v Royal Bank of Scotland plc* [2012] EWHC 3661 (QB).
[828] *Green and Rowley v Royal Bank of Scotland plc,* para 48. However, the judge accepted the principle of Rubenstein that for the advice to be given it is enough that the product is recommended to the client.
[829] *Green and Rowley v Royal Bank of Scotland plc*, para 82.
[830] *Green & Rowley v Royal Bank of Scotland plc* [2013] EWCA Civ 1197.

intention of Parliament to confer a private law cause of action upon a limited class.'[831]

The COBS rules

The similar approach has been recently put forward with regard to disputes regarding transactions concluded under the COBS rules, which transposed the MiFID I in the UK. In *Grant Estates Limited v RBS*, a venture company claimed damages for breach of COBS rules, breach of contract, negligent advice and misrepresentation in relation to the mis-selling an interest rate hedging arrangement with RBS.[832] The Scottish Court of Session dismissed the claims based on negligent advice, because *the* contractual documentation excluded expressly any advisory duty. The most interesting aspect of this case is that the claimant claimed that the COBS should be interpreted considering the MiFID I. This was because the COBS rules restrict the private cause of action in a way that is incompatible with the MiFID because it excludes from the scope of 'private persons', among others, the individuals who carry out the business of any kind. Section 150 FSMA 2000 requires that action must be taken by a private person who is an individual or legal person unless he or she suffers the loss in question in the course of carrying on a regulted activity. By restricting the scope of the private cause of action in that way, the UK has transposed the MiFID I in a discriminatory way. The Court however dismissed this claim because the MiFID I did not require Member States to establish a private cause of action and the private cause of action under Section 150 FSMA was not introduced to transpose EU law.[833] In conclusion, the Court implicitly rejected the view that COBS or the MiFID I can give rise to an additional duty of care to give advice to clients.

In other two recent cases, however, UK Courts adopted a more open approach with regard to the interplay between regulatory and common law duties. In *Basma Al Sulaiman v Credit Suisse Securities (Europe) Ltd,* the plaintiff, a high net worth investor,

[831] *Green & Rowley v Royal Bank of Scotland plc,* para 30. See also before: Hall v Cable and Wireless Plc [2009] EWHC 1793 (Comm), para 16.
[832] *Grant Estates Limited vs RBS* [2012] CSOH 133 CA152/11.
[833] Grant Estates Limited vs RBS, para 47.

claimed that the financial firm recommended unsuitable leveraged transactions and claimed compensation for breach of statutory duty (including COBS 5.4.3. and 9.2.1) under Section 150 FSMA, contractual or tortious common law duty.[834] The High Court dismissed the claims but found that advice was given to the client; therefore, the High Court confirmed that a duty of care in contract and tort is co-extensive with the regulatory duties and "the reasonable steps required under COB and COBS correlate with the exercise of reasonable care required in contract and tort to achieve the same ends".[835]

A more significant case is *Crestsign Ltd v NatWest and RBS,* where a limited company carrying out a business in commercial property alleged the mis-selling of an interest rate swap for letting to commercial tenants. The Judge decided that the firm did not breach the the duty of care to use reasonable skill and care when giving advice, because the bank successfully disclaimed responsibility for any advice[836] and that the firm did not give misleading information with respect to the swap. The reason is that whereas the bank is under the duty to explain fully and accurately the nature and effect of the products in respect of whether it chose to volunteer an explanation, it does not have any duty in respect to a product that the client might wante to purchase but which the bank did not wish to sell.[837]

Two points of the argumentation are remarkable. First, the Judge acknowledged that the transaction was afflicted by the defects subsequently found by the FSA in its pilot findings in 2012 (failure to ascertain the customer's understanding of risk; non-advised sales straying into advice; a mismatch between the duration of the hedge product and the underlying loan; and rewards and incentives being a driver of such practices).[838] Second, the Judge reiterated the principle that the regulatory and common law duties are not coextensive but held that 'it does not follow that breaches

[834] *Al Sulaiman v Credit Suisse Securities (Europe) Ltd & Anor* [2013] EWHC 400 (Comm)
[835] *Al Sulaiman v Credit Suisse Securities (Europe) Ltd & Anor*, para 18.
[836] *Crestsign v The Royal Bank of Scotland* [2014] EWHC 3043 (Ch), para 114 and 176.
[837] *Crestsign v The Royal Bank of Scotland,* para 153.
[838] *Crestsign v The Royal Bank of Scotland,* para 121.

of COBS duties (not actionable as such at the suit of Crestsign) cannot also be negligent at common law. Nor is the content of the COBS duties wholly irrelevant in a common law claim brought by a person unable by statute to sue for breach of a COBS duty. The COBS duties are likely to be relevant in determining the standard of care required of a reasonably careful and skilled adviser, since a reasonably skilled and careful adviser would not fall short of the standard required to meet relevant regulatory requirements.'[839] However, this statament did not overule *Green and Rowley* because while in *Crestsign* the court faced the issue of whether banks owe common law duties to clients, irrespective of their regulatory duties enshrined in COBS rules, in *Green and Rowley* the courts dealt with the narrower issue of whether common law duty was co-exstensive with regulatory duties. Consistently, the Judge acknowledged that bank owed common law duties when distributing financial products to clients. This duty is narrower than a duty to advice but wider than the mere duty not to mis-state.[840]

As the Judge himself noted, this conclusion was, however, "a Pyrrhic victory of principle but a defeat on the facts" because the bank gave negligent advice but succesfully disclaimed its responsibility for it and the information provided to the client was not miselading.[841] *Crestsign* was a Pyrric victory also because in the recent case *Thornbridge Ltd v Barclays Bank Plc*, which concernd the mis-selling of interest rate swap to a private limited company, the High Court did not follow the reasoning in *Crestsign* and resorted to the more restrictive view of *Green and Rowley*.[842] In particular, the High Court, by dismissing the claims for breach of statutory duty and negligent advice, clarified that, irrespective of whether a common law duty of care could exist, a financial firm can be held liable at common law only for negligent mis-statement but not on negligent advice, unless it took responsability for this advice.[843]

In conclusion, the examined case law shows that the relationship between regulatory

[839] *Crestsign v The Royal Bank of Scotland,* para 127 and 146.
[840] *Crestsign v The Royal Bank of Scotland,* para 143-148.
[841] *Crestsign v The Royal Bank of Scotland,* para At 177. The Judge also added that 'while the result may seem harsh to some, it is not the role of the common law and this court to act as a regulator'.
[842] *Thornbridge Ltd v Barclays Bank Plc* [2015] EWHC 3430 (QB).
[843] Thornbridge Ltd v Barclays Bank Plc [2015] EWHC 3430 (QB), para 130.

duties and common law duties is crucially dependent on the distinction between advisory or non-advisory nature of the transaction.[844] In advisory relationships, courts accept that the duty of care at common law must be informed by the regulatory duties; in non-advisory relationships, where the client takes the full responsibility for the instruction given to the financial firm, the financial firm does not owe any duty of care with respects to advice but can only be held liable for negligent misstatements and misrepresentations.

2.4.3. What private law remedies can be granted to investors for breach of regulatory duties?

A) The statutory cause of action: Section 138D FSMA 2000

Section 62 of the 1986 the Financial Services Act established that a contravention of rules made under the Financial Service Act 'shall be actionable at the suit of a person who suffers loss as a result of the contravention subject to the defences and other incidents applying to actions for breach of statutory duty.'[845] Following the concerns raised by the financial industry that this private cause of action would encourage strategical litigation,[846] the scope of the action was restricted to the 'private investors'.[847] The FSMA 2000 maintained this cause of action (Section 150) and established that the notion of 'private person' as referring to natural and legal persons unless they suffered the loss in the course of carrying on business of any kind.[848] This cause of action requires, first, that the compensation is available for the breach of a rule; the FSA and afterwards the FCA clarified that the breach of 'relevant requirement', 'principles for business' and 'statements of principles', 'evidential

[844] See P. Reynolds. 'Selling financial products: the interface between regulatory and common law standards' 269.
[845] See A. Hudson. *The Law of Finance*, p. 793.
[846] See DTI Consultation Paper 'Defining the Private Investor' September 1990 (Department of Trade and Industry). See also E. Lomnika. 'Private Damages Claims for Breaches of Securities Regulation Law' in R. Plender (ed.). *Legal History and Comparative Law. Essays in Honour of Albert Kiralfi*, p. 133.
[847] Section 193 of the Companies Act 1989.
[848] See Financial Services and Markets Act 2000 (Rights of Action) Regulations 2001 ('the 2001 Regulations') (SI 2001 No 2256).

provisions' and 'guidance' fall outside the notion of rule under section 150.[849]

The most vexed issue with regard to this statutory cause of action concerns the meaning of 'private person'. This issue was thourougly considered in *Titan Steel Wheels Ltd v Royal Bank of Scotland plc.* [850] Titan, a creator of steel wheels for the 'off-highway' vehicle industry, claimed compensation under Section 150 FSMA and negligent advice for the mis-selling of two derivative products. The Judge dismissed the claim for a statutory duty because he or she decided that the notion of ' (b) any person who is not an individual, unless he or she suffers the loss in question in the course of carrying on business of any kind' must be interpreted broadly as including not only the the financial transactions that form integral part of the business carried on with exclusion of those who were merely incidental to the business activity but also the transactions that are 'incidental', if the scale and frequency of the hedging is well sufficient to satisfy any requirement of regularity'.[851] Following this strict view, in subsequent judgments the UK Courts denied the right to standing under Section 150 of the FSMA to the wife of a private investor,[852] a corporation with a sole shareholder,[853] an investment company[854] and property developing companies.[855] As a final remark on the statutory cause of action, it must be borne in mind that the principles of causation, foreseeability and/or remoteness of damage apply as prescribed by tort law but they may operate in different ways, depending on the purpose of the conduct of business rule that was breached.[856]

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[849] See Palmer's Company Law. The Protection of Investors and the Regulation of Financial Services. Civil liability for certain breaches of the FSMA 2000 regime, vol. 3., London: Sweet and Maxwell, 2017, Section 10.

[850] *Titan Steel Wheels Limited v The Royal Bank of Scotland Plc* [2010] EWHC 211 (Comm) 2010 WL 442366.

[851] Bettween 2000 and 2007 Titan purchased 23 structured foreign currency products from the Bank and 20 similar products from other banks. The overall figures amounted to between euro100m and 200m. At 75.

[852] *Gorham v British Telecommunications Plc* [2000] 1 W.L.R. 2129.

[853] *Diamantides v JP Morgan Chase Bank* [2005] EWCA Civ 1612, [2005] All ER (D) 323 (Dec).

[854] *Camerata Property Inc v Credit Suisse Securities (Europe) Ltd Q* [2012] EWHC 7 (Comm) para 94-98.

[855] *Nextia Properties Limited v The Royal Bank of Scotland plc, National Westminster Bank plc* [2013] EWHC 3167 (QB) para 104; *Grant Estates Ltd v RBS* [2012] CSOH 133, para 62.

[856] See A. Hudson. The Law of Finance, p. 794. See also *SAAMCO v. York Montague Ltd* [1997] AC 191, para 212 and *Rubenstein v HSBC Bank Plc*, para 45.

B) The tort of negligence

Whilst in the civil law countries examined above, the recurrent remedies sought by the claimants are based in contract law (avoidance, compensation for pre-contractual or contractual liability or termination of contract), in the UK the most recurrent civil wrong sought by the claimant is the tort of negligence with particular regard to the statements or the advice given by the firm to the client. These claims can give rise to the compensation of (non-economic) loss if the following conditions are met: (i) the defendant owes a duty of care to the claimant; (ii) the breach of the duty of care caused a damage to the claimant; and (iii) there is a causal link between the breach and the damage.[857]

Negligent mis-statements

The duty of care aims to "demarcate the range of people, relationship and interest that receive the protection of the law from the effects of negligently imposed harm".[858] In financial litigation the two most important applications of the duty of care concern the allegations for negligent mis-statements (or misrepresentations) and negligent advice.[859]

The foundation of the liability for negligent mis-statements is the landmark *Hedley Byrne v Heller* where the House of Lords decided, for the first time, that if the bank has explicitly or implicitly assumed responsibility for giving information or advice, it is liable for the negligent misstatements made to the client and msut recover the

[857] See S. Deaking, A. Johnston, B. Markesinis. Markesinis and Deakin's Tort Law, 7th Edition, Oxford: Oxford University Press, 2012, p. 99. A. Hudson. The Law of Finance p. 767 refers to five conditions: (i) breach of duty of care (ii) causal link between the breach and the damage (iii) foreseeability (iv) proximity (v) fair, just and reasonable to impose liability. Jackson and Powell on Professional Liability, to the three conditions of: (i) duty of care (ii) breach of duty of care (iii) damage.
[858] *Markesinis and Deakin's Tort Law*, p. 102.
[859] See, for the detailed analysis of the case law on the duty of care in financial litigation, K. Alexander. 'Bank Civil Liability for Mis-selling and Advice' p. 261.

economic loss suffered by the client.[860] The House of Lords specified that, in principle, wherever there is a relationship equivalent to contract there is a duty of care but specified that in any case it is necessary to examine the particular facts to see whether there is an assumption of responsability; an implied assumption of responsability can be inferred from the nature of the relationship including between social and professional relationships and whether the adviser is acting purely out of good nature or whether he or she is getting his or her reward in some indirect form. In subsequent judgments, however, English courts criticized the assumption of responsability test and relied upon different tests to identify a duty of care (i.e. the threefold test and the incremental test).[861]

However, in *Her Majesty's Commissioners of Customs and Excise v. Barclays Bank plc Lord* Bingham held that 'the outcomes (or majority outcomes) of the leading cases cited above are in every or almost every instance sensible and just, irrespective of the test applied to achieve that outcome' and stressed that attention must be given to 'the detailed circumstances of the particular case and the particular relationship between the parties in the context of their legal and factual situation as a whole.'[862] On the basis of the facts of the case, the case law has specified that the duty not to give negligent misstatements, does not comprise the regulatory duty to communicate clearly or fairly (COB 2.1.3R)[863] and that the liability for mis-statements can be successfully disclaimed by express contract terms, such as "you agree that you will rely on your own judgment for all trading decisions" or "any trading recommendation, market or other information communicated to you […] gives no representation […]".[864] Similarly,

[860] *Hedley Byrne v Heller* [1964] AC 465 at 510. The House of Lords overrulled the prcedent *Candler v Crane, Christmas & Co* [1951] 2 KB 164, by expressly upholding the dissenting opinion delivered by Denning LJ in this judgment. However, *Hedley Byrne v Heller* the House of Lords decided, on the facts, that the bank effectively disclaimed any assumption of a duty of care.
[861] See, in detail, on the different tests: Jackson and Powell on Professional Liability, p. 18-24 and Lord Bingham in para 4.
[862] *Her Majesty's Commissioners of Customs and Excise v. Barclays Bank plc* [2007] 1 AC 181 para 189; [2006] UKHL 28, para 4 *per* Lord Bingham. See in the same vein, Lord Hoffmann, para 35.
[863] *Green and Rowley v. Royal Bank of Scotland plc* para 168 and *Thornbridge Ltd v Barclays Bank Plc* [2015] EWHC 3430 (QB).
[864] *Bank Leumi (UK) Plc v Linda Joy Wachner* [2011] EWHC 656 (Comm), in para 184 (reference to the clauses cited in the text). See also *Peekay Intermark Limited v Australia & New Zealand Banking Group*

according to the UK Courts – and therefore differently from the Italian and Spanish courts – the bank's failure to disclose the brekeage costs or mark-to-market of the interest rate swap does not amount to a misrepresentation if the bank dislaimed its liability for misrepresentation.[865]

Negligent advice

To decide whether financial firms owe a duty to give advice to clients, courts have followed a pragmatic approach, starting from the examination of 'lower level factors' rather than high abstractions.[866] In *Bankers Trust International PLC v. PT Dharmala Sakti Sejahtera*, a case concerning the mis-selling of interest rate swaps to a financial firm, Mance J held that "the ultimate decision whether to recognise a duty of care, and if so of what scope, is pragmatic". [867]A similar pragmatic approach in the assessment of the duty of care was followed in *JP Morgan Chase Bank v Springwell Navigation Corp*.[868] In this case, Springwell, a financial firm owned by the Polemis family, who owned and operated a large Greek shipping fleet, suffered a loss as a result of an investment in 'GKO-Linked Notes' which were devaluated after the Russian 1998 default. The plaintiff brought a number of claims against Chase, including damages for negligence advice, breach of contract, breach of fiduciary duty, negligent mis-statement and/or under the Misrepresentation Act 1967. The High Court and the Court of Appeal dismissed all the claims.[869]

With particular regard to the claim for negligent advice, Gloster J examined several 'lower level factors' which could provide evidence of a duty of care the contractual

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[2006] EWCA Civ 386, paras 56-57 and *Springwell Navigation Corporation v JP Morgan Chase Bank* [2010] EWCA Civ 1221 at paras 84 and 141-169.

[865] *Nextia Properties Ltd v Royal Bank of Scotland plc* [2013] EWHC 3167 (QB)

[866] *Her Majesty's Commissioners of Customs and Excise v. Barclays Bank*, para 36, per Lord Hoffmann.

[867] *Bankers Trust International PLC v. PT Dharmala Sakti Sejahtera* [1996] CLC 518, para 534. In making the decision not to identify a duty of care, Mance J attached crucial importance to the circumstance that the client was a sophisticated investor and that the purpose of the transaction was speculation rather than hedging (para 574).

[868] *JP Morgan Chase Bank and Others v Springwell Navigation* [2008] EWHC 1186 (Comm).

[869] *Springwell Navigation Corporation (a Body Corporate) v Jp Morgan Chase* [2010] EWCA Civ 1221.

context, (documentation), the type of clients (experience and sophistication), and the regulatory background (pre-FSMA 2000 regime).[870] Gloster J first distinguished "the investment advisor, properly so-called, who is retained to advise a client, usually backed by considerable research [...] and the advice or recommendations given by a bonds salesperson [...] as part of the selling process', which does not amount to investment advice".[871] Second, she introduced an important distinction between giving advice and assuming responsability for that advice. Whilst the advice can be given also in the daily interactions between an institution's sales force and a purchaser of its products, the advice gives rise to legal obligations in tort or delict to exercise reasonable care on the basis of the terms of the legal relationship between the parties.[872]

In this respect, the absence of any written advisory agreement "is a significant pointer against the existence of an advisory obligation" because if the defendant had assumed such a responsibility, he could have defined the scope of its duties in a written document.[873] Although the Judge herself recognized that this decision was based on the facts of the case and that they might be other cases where a duty of care and obligations to advise arise in the absence of express contractual documentation,[874] in several subsequent judgments the English courts decided, that even if the transactions were subject to the COB[875] and COBS[876] regimes, in the absence of an express advisory agreement, the mere fact that the financial firm expresses its opinion or advice does not mean that the firm owes a duty of care to the client. When advice is given, courts

[870] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 53. See also Standard Chartered Bank v Ceylon Petroleum Corporation [2011] EWHC 1785 (Comm), para 478.
[871] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 361 and 452.
[872] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 374 and Standard Chartered Bank, para 544.
[873] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 440.
[874] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 454.
[875] *Wilson v MF Global UK Limited* [2011] EWHC 138 (QB) para 94. See however *Rubenstein v HSBC Bank Plc* [2011] EWHC 2304 (QB) para 81, where the Judge held that if the information is either accompanied by a comment or value judgment on the relevance of that information to the client's investment decision, the information is a recommendation.
[876] *Bank Leumi (UK) plc v Wachner* [2011] EWHC 656 (Comm), para 198; *Standard Chartered Bank v Ceylon Petroleum Corporation* [2011] EWHC 1785 (Comm), para 508; *Grant Estates Limited v RBS*, para 73.

accept that a duty of care is co-extensive with the regulatory duties because 'the reasonable steps required under COB and COBS correlate with the exercise of reasonable care required in contract and tort to achieve the same ends';[877] by contrast, when advice is not given and firms have not assumed responsibility for the advice, no duty of care can arise in common law.

The causation in liability claims

Since the overwhelming majority of claims for negligent misrepresentation and negligent advice have been dismissed due to the lack of a duty of care, only in a few cases courts went on to examined whether there was a causal link between the breach of this duty and the loss suffered by the client. The traditional causation test applied by UK courts is centred on the 'but-for cause'; namely, the necessity of ascertaining, through counter factual analysis, whether, had the investor been properly informed or advice, he or she would have purchased the same financial instrument.[878]

In *Beary v Pall Mall Investments* the Court of Appeal dismissed the claim for compensation, *inter alia*, because the plantiff did not manage to prove that if a correct advice had been given, he would have purchased a different investment products.[879] Importantly, the Court of Appeal refused to follow the Chester v Afshar, a health care liability case, where the House of Lord exceptionally departed from the traditional 'but for test' for policy reasons, i.e. in order to give an fair remedy for the loss suffered by the patient.[880] The Court of Appeal considered that analogy between a breach of the doctor's duty of care and breach of the duty of care owed by financial advisers (whether in relation to pensions or otherwise) is unconvincing and that "the suggestion that the established principles of causation should be rejected in *all* cases of

[877] *Al Sulaiman v Credit Suisse Securities (Europe) Ltd & Anor*, para 14.
[878] See in particular *Markesinis and Deakin's Tort Law*, p. 106.
[879] *Beary v Pall Mall Investments* [2005] EWCA Civ 415.
[880] *Chester v Afshar* [2004] UKHL 41, [2005] 1 AC 134. The patient received compensation even if she could not show that, if she had been properly informed, she would not have had the surgery after she had considered other options.

negligent financial advice is breathtakingly ambitious, contrary to authority".[881] As Gloster J decided in *JP Morgan Chase Bank and Others v Springwell Navigation,* in a non-advised relationship, the plaintiff should prove that the information received has in fact determined the choice of the investor.[882]

The traditional approach to causation was further confirmed in litigation regarding the mis-selling of Lehman Brothers products. The Camarata saga is a remarkable example of litigation for the mis-selling of Lehman Brothers products. Between 2007 and 2008 the claimant (Camerata, an investment firm), entered in a series of derivative contracts (structured notes) related to Lehman Brother's products with Credit Suisse (CSSE) for approximately US 25 million.

Following the losses suffered after the default, Camarata brought three lawsuits against Credit Suisse which have been dismissed by three judgments of the High Court. In the first Camerata case the plaintiff did not allege the mis-selling of the Note but that if he had had been correctly informed about the Lehman's rist of default he would have sold that Note. [883] Even if the Judge found that the bank did not breach the duty of care in relation to the advice given to the client, he established that no causal link could be established between the breach and the loss. The Judge accepted that if the adviser had informed the client about a serious risk of default, the client would have sold the Note.[884] However, the Judge held that such an advice 'would have been more pessimistic than would have been reasonable and proper', and that the correct advice should have limited to the worsening of the Lehman's rating and some speculation on his position in the press;[885] but this advice, in light of the investor's knowledge and experience, would not have led him to make a different investment.

This reasoning was confirmed also in the second and third Camarata case where the

[881] *Beary v Pall Mall Investments* [2005] EWCA Civ 415, para 38.
[882] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 639.
[883] *Camerata Property Inc. v Credit Suisse Securities (Europe) Ltd.* [2011] EWHC 479 (Comm)
[884] *Camerata Property Inc. v Credit Suisse Securities (Europe) Ltd.*, para 238.
[885] *Camerata Property Inc. v Credit Suisse Securities (Europe) Ltd.*, para 239.

High Court decided that there was no causal link between the alleged breach of the duty of care and COBS suitability rules and the loss because the investor, given his knowledge, experience and attitude to risk, would not have made a different investment, even if correct advice was given.[886]

Similarly, in *Basma Al Sulaiman v Credit Suisse Securities (Europe) Limited, Plurimi Capital LLP* where the claimant invested into he 23 structured notes whose value collapsed after the Lehamn Brothers failure and triggered the margin calls by the bank to provide additional collateral which the investor did not meet. The claim for negligent adviced failed because the Lehamn Brothers collapse was unforeseebale and therefore the risk of margin call was extremely remote but also because even if the investor had been informed about the risk of margin call of US 5 million, she would not have changed her investment strategy given her high attitude towards risk.[887]

The quantification of damages

The basic object of an award of damages in tort is to put the injured party in the same financial position as he would have been in if he or she had not sustained the wrong for which he or she is being paid compensation.[888] To this end, Courts examine whether the plaintiff contributed to the damage,[889] whether the financial instrument had any residual value which should be considered at the time of the litigation[890] and whether the investor was in the position to "take a truly independent trading decision" in order to avoid or reduce the amount of the loss.[891]

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[886] *Camerata Property Inc v Credit Suisse Securities (Europe) Limited* [2012] EWHC 7 (Comm) 2012 WL 14689, para 88. *Camerata Property Inc. v Credit Suisse Securities* (Europe) Limited [2013] EWHC 29 (Comm) 2013 WL 128088, para 4.

[887] *Basma Al Sulaiman v Credit Suisse Securities (Europe) Limited, Plurimi Capital LLP* [2013] EWHC 400 (Comm) 2013 WL 617348, para 164.

[888] *Livingstone v Rawyards Coal Co* (1880) 5 App Cas 25, 39, cited by *Cassa Di Risparmio Della Repubblica Di San Marino Spa v Barclays Bank Ltd* [2011] EWHC 484 (Comm), para 547.

[889] See *Spreadex Limited v Sanjit Sekhon* [2008] EWHC 1136 (Ch) 2008 WL where the amount of damages was reduced due to the contributory negligence of the plaintiff.

[890] *Camarata Property Inc. v Credit Suisse Securities (Europe) Ltd.* [2011] EWHC 479 (Comm) 2011 WL 674989, para 241.

[891] *Cassa Di Risparmio Della Repubblica Di San Marino Spa v Barclays Bank Ltd* [2011] EWHC 484 (Comm), para 560. The High Court decided that the investor remained to a significant extent 'locked

Another fundamental criterion adopted by UK Courts to calculate the recoverable damage is the remoteness or foreseeability of the loss. This requirement is close to the causation but it concerns a legal examination of the extent to which a loss, which was caused by the defendant's conduct, can be wholly recovered on the basis of the extension of the duty of care owed to the plaintiff. This question was examined in depth in *Rubenstein v HSBC Bank plc*, mentioned above, where the Court of Appeal, by overturning the judgment of the High Court, decided that the loss suffered by the retail investor, as a result of the Lehman Brothers collapse, was not too remote.[892] The Court of Appeal held that, although the insolvency of Lehman Brothers may have been unforeseeable, the remoteness test should consider the purpose of the statutoty rules which aim at protecting consumers (i.e. the consumer protection objective of Section 2 FSMA 2000 and the COB rules).[893] In additon, the Court of Appeal went so far as to say that 'where the obligation of a defendant is not merely to avoid injuring his or her claimant but to protect him from the very kind of misfortune which has come about, it is not helpful to make fine distinctions between foreseeable events which are unusual, most unusual, or of negligible account.'[894] Differently from the *Camarata* cases, the Court of Appeal considered that the question was not whether the failure of the issuer was a stake but rather the financial instrument was inherently unsuitable, irrespective of the failure of the issuer.[895]. However, whereas in *Camerata* the plaintiff was a sophisticated investor, in *Rubenstein* the plaintiff was a retail unsophisticated client.[896]

C) Remedies for the breach of an implied contract term

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into' the investment because the financial instruments were not readily marketable assets and it was unlikely that anyone other than the defendant bank would have been willing to buy them at a realistic price.

[892] *Rubenstein v HSBC Bank plc* [2012] EWCA Civ 1184, para 46. The Court of Appeal awarded £7,195.23 in compensation.
[893] *Rubenstein v HSBC Bank plc*, para 123.
[894] *Rubenstein v HSBC Bank plc,* para 124. The Court of Appeal mentioned also two decisions of the FOS in support of this claim that the bank is responsible for exposing the client to the risk of losses derived from the (unforeseeable) Lehman Borthers collapse.
[895] *Rubenstein v HSBC Bank plc*, para 112.
[896] The Court of Appeal reiterated that the plaintiff should be considered as a cosumer. See para 115.

Unlike continental courts, UK courts are reluctant to accept that, in the absence of any parties'agreement, regulatory duties can be incorporated into the financial contract. Whilst in few cases (pre-FSMA 2000) English courts held that regulatory provisions, promulgated by self-regulatory bodies (e.g. London Code of Conduct), can be implicitly incorporated into contracts,[897] in most cases courts have declined to treat regulatory duties as contract duties because the client can actionate these regulatory duties with the statutory cause of action and therefore there is no need to treat these duties as contract duties.[898]

For this reason, in several recent judgments, the High Court firmly rejected the plaintiff's claim that the COBS rules, implementing MIFID rules, can be incorporated, by implication, into contracts,[899] and therefore denied the contract law nature of MIFID derived conduct duties.

D) Mis-representation

The tort of misrepresentation and and the tort of deceit under the Misrepresentation Act 1967 require the plaintiff to prove that a) the defendant made a representation; b) the representation was false; c) the plaintiff relied upon this representation; d) as a result of which, he suffered losses.[900] According to the Misrepresentation Act, the remedies for misrepresentation depend on whether the misrepresentation was fraudulent, negligent or innocent. In all such cases, the innocent party may seek rescission – an equitable remedy which means the contract is set aside and the parties

[897] *Larussa-Chigi v CS First Boston Ltd.* [1998] C.L.C. 277 and *Brandeis Brokers Ltd v Black [2001] 2 Lloyd's Rep. 359.*

[898] However see *Clarion Ltd v National Provident Institution* [2000] 1 W.L.R. 1888; *Bear Stearns Bank Plc v Forum Global Equity Ltd* [2007] EWHC 1576 (Comm).

[899] *Thornbridge Ltd v Barclays Bank Plc* [2015] EWHC 3430 (QB), *Redayne Bentley Stockbrokers v Isaacs [2010] EWHC 1504 (Comm), Wilson v MF Global UK Ltd [2011]* EWHC 138 (QB)), *Bailey & Anor v Barclays Bank Plc* [2014] EWHC 2882 (QB), para 55 and *Grant Estates Limited vs RBS*, para 67.

[900] A representation is a statement of fact (not an opinion) made by the representor to the representee on which the representee is intended and entitled to rely as a positive assertion that the fact is true. To identify a representation, account must be given to the context in which it was made and the impact it might be expected to have on a reasonable representee in the position and with the known characteristics of the actual representee: see *Raiffeisen Zentralbank Österreich AG v Royal Bank of Scotland Plc* [2010] EWHC 1392 (Comm), para 81 (the plaintiff alleged the mis-representation of the defendant bank which arranged a syndicated loan).

are restored to the position they were in prior to entering into a contract. In a case of a fraudulent or negligent misrepresentation, the innocent party may seek damages instead of or in addition to rescission, either at common law or under section 2(1) of the Misrepresentation Act 1967.

In a case of negligent or innocent misrepresentation, the court may award damages in lieu of rescission under section 2(2) of the Act.[901] Unlike the Misrepresentation Act 1967, the tort of deceit requires also that there must be proof of fraud or recklessness and the claimant can only be awarded compensation damages. Fraud is proven where the false representation has been made (a) knowingly, (b) without belief in its truth; recklessness, when the party, albeit having no knowledge of its falsehood, he believed belief in its truth and made it, "not caring whether it was true or false".[902] It is not necessary for the plaintiff to prove the defendant's motive in making the representation (dishonesty) but the gross negligence is not sufficient to bring the claim succesfully.[903]

The two key questions examined by UK Courts are whether the defendant bank made a representation on which the claimant relies and whether this representation was intentional (i.e. whether the plaintiff knew that the representation was not true). The first question was considered in *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited* where the plaintiff, an investment firm, claimed damages for damages for misrepresentation under section 2(1) of the Misrepresentation Act 1967 against the defendant bank for the mis-selling of a structured product linked to the performance of a GKO note.[904]

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[901] *Raiffeisen Zentralbank Österreich AG v Royal Bank of Scotland Plc,* para 85, quoting Royscot Trust v Rogerson [1991] 2 QB 297, 'where there is room for an exercise of judgement, a misrepresentation should not be too easily found'.
[902] The leading case is Derry v Peak, at 368.
[903] Derry v Peak [1889] UKHL 1 and *Goose v Wilson Sandford & Co.* [2001] Lloyd's Rep PN 189, para. 41 and *AIC Ltd v ITS Testing Services (UK) Ltd* [2007] 1 Lloyd's Rep 555, paras 256-257.

[904] *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited* [2005] EWHC 830 (Comm).

The High Court upheld the claim because, even if the claimant did not carefully read the contractual documentation, given the 'considerable confidence' placed by the claimant in its Bank, the claimant had no reason to think that the terms and conditions he was expecting to receive would relate to a fundamentally different product from that which had been described to him.[905] The judge also observed that Peekay would not have made the investment if it had known that it would have no interest whatsoever in any GKO, which would merely be the Reference Obligation for the purpose of a derivative product, and no control over what was to happen in the event of a default in relation to that Reference Obligation.[906]

However, the Court of Appeal overturned this decision. Contrary to the High Court, the Court of appeal emphasized that a sophisticated investor cannot simply rely upon pre-contractual statements/description in particular where the contractual documents contain an accurate description of the terms and nature of the product.[907] Therefore, as long as the contract terms 'correct' a mis-representation previously made by the bank, 'a person who signs a document knowing that it is intended to have legal effect is generally bound by its terms, whether he has actually read them or not'.[908] As Lord Justice Moore-Bick pointed out: "it is an important principle of English law which underpins the whole of commercial life; any erosion of it would have serious repercussions far beyond the business community".[909]

The restrictive interpretation of the concept of misrepresentation, based on the literal interpretation of the contractual documentation, rather than the contextual of the transaction (e.g. nature of the client, type of financial instrument) was further re-

[905] *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited,* para 37.
[906] *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited*, para 92. Peekay was compensated with the difference between its investment and the return it actually received ($244.000).
[907] Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited [2006] EWCA Civ 386, para 27 and 67.
[908] *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited*, para 43.
[909] *Peekay Intermark Limited, Harish Pawani v Australia and New Zealand Banking Group Limited*, para 43.

affirmed in *Cassa di Risparmio della Repubblica di San Marino SpA (CRSM) v Barclays Bank Ltd*. In this case, a professional investor CRSM, claimed damages for the negligent and fraudolent misrepresentations made before the selling of a series of CDOs, alleging, in essence, that the defendant structured each of the CDO2s in such a way as to obtain a AAA rating for a product.[910] The High Court dismissed all the investor claims. The High Court found that the bank made no representation regarding the purchase of notes but, at best, provided its opinions or beliefs.[911]
But if such a representation had been made, according to Hamblen J, Barclays had no intention to mislead CRSM. The Judge admitted that Barclays, in order to increase its profits, deliberately selected entities for inclusion in the reference portfolios of the CDO2s that had high spreads for their ratings,[912] but concluded that Barclays expressed its views with reasonable grounds for belief in their truth.

Finally, as regards the reliance upon the Barclays's opinions, the Judge noted that, although a claim in misrepresentation arises irrespective of whether the parties carried out an advised or a non-advised sale,[913] contract terms clearly disclaimed any responsibility for advice or recommendation and that the buyer was contractually estopped from making its purchase representation claim, but not the restructuring representation claim.[914] In addition the Judge stressed that there was no need to imply a contract term that, in structuring the CDO2 incorporated in the relevant Note, Barclays would not do so with the deliberate intention that its risk of default would be materially different from that indicated by its anticipated AAA rating.

This is so because "contracts between banks for the sale and purchase of complicated

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[910] *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd* [2011] EWHC 484 (Comm), para 312.
[911] *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd*, para 266 (purchase's mis-representation) and 278 (restructuring's mis-representation).
[912] *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd*, para 314.
[913] *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd*, para 513.
[914] *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd*, paras 487-531. See, for the same view on the contractual estoppel, Peekay Intermark Ltd v Australia & New Zealand Banking Group Ltd [2006] EWCA Civ 386, [2006] 2 Lloyd's Rep. 511 and Springwell Navigation Corp v JP Morgan Chase Bank (formerly Chase Manhattan Bank) [2010] EWCA Civ 1221, [2010] 2 C.L.C. 705.

structured products work perfectly well on the basis of the principle of caveat emptor and the implication would render the contract uncertain, self-contradictory and unreasonable in its effect".[915] Following the same line of argument, in *Grant v Real Estate* the Scottish Court of Session emphasized a misrepresentation is fraudolent if there is "a clear and specific basis for the inference of dishonesty".[916] The need of providing a strong evidence for dishonesty is that 'allegations of dishonesty can have very serious consequences for people, particularly those engaged in regulated professions, and can blight careers, at least temporarily, even if they are eventually not substantiated.'[917]

E) UCTA 1977

The same approach has been followed with regard to the claims for the breach of Section 2(1) of the Unfair Contract Terms Act 1977 which provides that a person cannot exclude or restrict liability for negligence by a contractual term or notice unless it satisfies the requirement of reasonableness.[918] UK courts have consistently held that, in commercial transactions, such a clause is valid because it does not restrict not restricted or excluded liability but it rather defines the scope of contractual obligations.[919] This conclusion has been based on the conviction that these statutory provisions should have very limited application between commercial parties who are supposed to freely determine their own risks and responsibilities and to draft their contract terms accordingly.

F) Brach of fiduciary duties

[915] *Cassa di Risparmio della Repubblica di San Marino SpA v Barclays Bank Ltd*, paras 536-545.
[916] *Grant Estates Limited vs RBS*, para 89.
[917] *Grant Estates Limited vs RBS*, para 93. See also *Standard Chartered Bank v Ceylon Petroleum Corporation* [2011] EWHC 1785 (Comm), para 572.
[918] See also Section 3 of the Misrepresentation Act 1967.
[919] See *Springwell Navigation Corporation (a Body Corporate) v Jp Morgan Chase* [2010] EWCA Civ 1221, para 603; *Titan Steel Wheels Limited v The Royal Bank of Scotland Plc*, para 99; IFE v. Goldman Sachs [2006] EWHC 2887 *(Comm)*, para 71 and Grant Estates Limited vs RBS, para 87.

A fiduciary duty is duty undertaken by a person (fiduciary) "to act on behalf of or for the benefit of another, often as an intermediary with a discretion or power which affects the interest of the other who depends on the fiduciary for information and advice".[920] Fiduciary duties, however, have limited application in the financial sector and, more generally, in commercial relationships.[921] This is because in commercial transactions "the parties are expected to be the authors of their own rights and obligations".[922]

To understand whether a the firm-client relationship gives rise to a fiduciary duties, UK courts focus on the express or implied terms of the contract.[923] For example, in *Brandeis (Brokers) Limited v Herbert Black et al.*, the High Court found that a broker did owe a fiduciary duty to his clients because the substance of the relationship revealed that contractual relationship was essentially an agency relationship which is "by its nature a form of fiduciary relationship [because] otherwise an agent would be free to make a profit from his or her position behind the principal's back".[924] In *Springwell v JP Morgan,* however, where there was no advisory relationship between the parties, Gloster J rejected the plaintiff's view that the defendant had a fiduciary obligation to the investor because "the mere fact that one party to a commercial relationship 'trusts' the other does not predicate a fiduciary relationship".[925] The plaintiff, concluded the Judge, could not have "any legitimate expectation that, in its commercial dealings with Springwell, Chase would subordinate its interests to those of Springwell".[926]

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[920] Law Commission. Fiduciary Duties and Regulatory Duties. December 1995., Law Com No 236.
[921] See Law Commission. Fiduciary Duties of Investment Intermediaries. June 2014, Law Com No 350, 195. On the law on fiduciary duty, see, inter alia, P. Finn. 'Fiduciary law and the modern commercial world' in E. McKendrick (ed). Commercial Aspects of Trusts and Fiduciary Obligations, Clarendon Press, 1992, p 14.
[922] Law Commission. Fiduciary Duties of Investment Intermediaries, 195.
[923] Law Commission. Fiduciary Duties of Investment Intermediaries, 197.
[924] *Brandeis (Brokers) Limited v Herbert Black, American Iron and Metal Company Incorporated, Lito Trade Incorporated Representation* 2001 WL 513189, para 43. See, however, *Diamantis Diamantides v JP Morgan* [2005] EWCA, para 43, the Court of Appeal decided that the bank did not owe fiduciary duty to the investor, who was the sole owner of an investment vehcile with whom the bank concluded a derivative contract on advisory basis.
[925] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 573.
[926] *JP Morgan Chase Bank and Others v Springwell Navigation*, para 574.

3. Convergent trends and divergences

The foregoing has brought to light convergent and a divergent trends as to the extent extent to which the EU conduct of business rules affect national private law and what remedies are granted by courts to clients who suffered a loss as a result of the firms' breach of conduct of business rules.

3.1. Private law duties: Are they stricter than regulatory duties?

At first sight, a clear divergence emerges between continental jurisdictions and the UK as regards the impact of the EU conduct of business rules on national private law

In the examined continental jurisdictions, national courts, even before the financial crisis and the entry into force of the MiFID I, have imposed on financial firms stricter duties of care than that foreseen in the ISD and, despite the absence of an express private law remedy, they have conferred on clients remedies based on general private law, in advised and non-advised relationships. To achieve this outcome, national courts have generally interpreted contract terms and national contract law in light of the primary purpose of EU conduct regulation, namely the protection of clients.

By contrast, in the UK, the majority of courts held that, especially in non-advised relationships, the general common law cannot be stricter than regulatory duties and cannot lead to the imposition of the financial firms of other remedial consequences than those expressly established by statutory law. The UK courts, instead, are more inclined to impose on the firm a duty of care at common law, in addition to the regulatory duties, in advisory relationship, the reason being that in such a case the client's investment decision is determined by the firm and therefore the firm's breach of regulatory duties exert a greater impact on the client's decision-making. However, the textualist interpretation of contract terms,[927] the doctrine of contractual estoppel

[927] See S. J. Choi, G. Mitu Gulati. 'Contract as Statute' 104 Michigan Law Review (2006): 1146 (distinguishing between textualist and contextual interpretation) and J. P. Braithwaite. 'Standard Form

and the need to ensure the freedom of contract and commercial certainty make it difficult for clients to prove the existence of an advisory relationship with the firm and therefore restrict to a large extent the possibility to actionate the breach of regulatory duties with common law remedies.[928]

Notably, the utilitarian conception of freedom of contract[929] and the textualist interpretation of contracts[930] are two distinctive characters of the common law, as opposed to the civil law tradition.

However, in this study, these differences should not be overemphasised. This is because the context of litigation is profoundly different. Whereas in continental jurisdictions courts deal with mass-retail litigation, between unsophisticated clients and intermediaries, in the UK courts deal with litigation triggered by sophisticated clients against financial firms often acting as their contractual counterparties, thus on a similar level playing field. Therefore, the 'investor-friendly' approach of continental judges, in comparison to the 'bank-friendly' approach of common law judges, could be explained by the very different economic and bargaining power of the plaintiffs vis-à-vis the defendant firm in two juridictions.

Another important difference concerns the institutional setting for retail clients redress. In the UK the FOS, due to its broad competence (up to £ 150,000 and including legal persons) can capture most of the mass-retail dispute which in the EU are litigated in courts. More importantly, the FOS adopts a very informal adjudication approach which avoids the textualist interpretation techniques of UK courts thus granting a high level of protection to retail clients.

Contracts as Transnational Law: Evidence from the Derivatives Markets' 75 The Modern Law Review (2012): 779–805.

[928] See K. Alexander. 'Bank Civil Liability for Mis-selling and Advice' in D. Busch, C. Van Dam (eds.). A Bank's Duty of Care, p. 260.

[929] See H.-W. Micklitz. 'On the Intellectual History of Freedom of Contract and Regulation', 1.

[930] See H.-W. Micklitz. 'The Politics of Judicial Co-operation in the EU Sunday Trading, Equal Treatment and Good Faith', Cambridge: Cambridge University Press, 2005, p. 35.

3.2. Private law remedies: Compensation or restitution?

The comparative analysis has shown that the breach of the MiFID conduct of business rules can give rise to compensatory remedies (pre-contractual, contractual and tortious liability) and, only exceptionally, to restitutionary remedies, primarily as a result of the avoidance of contract.[931] Compensatory remedies aim to compensate the investor's loss, which typically corresponds to the difference between the price paid for the security and its the real or actual value at the date of sale ('out of pocket rule'). Restitutionary remedies aim to reverse to the investor all the benefits earned unjustly by the defendant: the damages correspond to the entire price paid by the investor to the firm at the date of sale. For this reason,restitutionary damages are an attractive remedy for investors because, even if the amount of restitution could also be lower than that deriving from compensation (i.e. when the purchase price is lower than the out of pocket loss), they grant the client the purchase price, without need of proving the loss, the causal connection and the amount of the recoverable damage.[932] However, restitutionary remedies lead to inefficient outcomes in particular because they force the firm to reverse also the costs saved in the transaction[933] and because they reduce the incentives for the clients to take informed investment decisions and to prevent the worsening of the losses caused by the firm. In addition, restitutionary remedies, especially if deriving from the avoidance of standard contract terms in banking contracts can produce a systemic harm, namely triggering a cascade of restitutionary claims that could deplete the assets of the credit institution and consequently reduce its lending activities to the real economy. [934]

Intermediate conclusion

[931] In general, in the case of termination of contract, the restitution is not automatic; the plaintiff has to prove that the breach is sufficiently serious.
[932] For the quantification of loss in compensation damages, see R. B. Lee. "The Measure of Damages Under Section 10(b) and Rule 10b-5", 1266 Modern Law Review (1987): 1269.
[933] For a criticism of restitutionary damages see F. H. Easterbrook, D. R. Fischel. 'Optimal Damages in Securities Cases', 635 and L. Fuller and W. Perdue. '*The Reliance Interest in Contract Damages*' 46 Yale Law Journal (1936): 52.
[934] See J. Kongden. '*Policy Responses to Credit Crisis. Does the Law of Contract Provide an Answer?*' in S. Grundmann, Y. M. Atamer, Financial Services, Financial Crisis and General European Contract Law, p. 44.

The Part II of the thesis has examined how national and EU institutions have enforced and implemented, before and after the global financial crisis, self-imposed (contracts) and externally-imposed (contract law, financial regulation) requirements.
A preliminary conclusion is that the EU conduct of business rules, whilst originally designed from a public enforcement perspective to regulate markets have become, in the 'law in action', a tool to drive the interpretation and enforcement of retail financial contracts and national private law. However, the degree of influence of the EU conduct of business rules on private law duties and remedies depends upon the institutional and national context.

The examined jurisdictions show a high degree of convergence in client protection supervision. This has generally moved from a traditional ex post, conduct-based approach, to an ex ante and product-driven approach, more intrusive with the regulation of financial instruments and products, which inevitably influences, at least, indirectly the interpretation of contractual obligations between firms and clients. This move has been driven not only by domestic factors (i.e. urgent need to tackle mis-selling, in particular in Spain and the UK), but also by the emphasis placed by the ESMA on the need to take earlier action to mitigate the retail client detriment.

A second convergent trend, driven by the EU, has led to the development of the ADR for retail client disputes. Whereas in the UK the FOS was well established before the financial crisis and the entry into force of the MiFID, in Italy, Spain and France, the ADRs in the financial sector represent a post-crisis phenomenon, triggered by the large scale of detriment caused by mis-selling and legally supported by the MiFID provisions. In continental jurisdictions, the 'incorporation' of the ADR bodies into the institutional structure of the NCAs, contribute to the achievement of their consumer protection mandate, thus assuming a monitoring or lato sensu supervisory function and mitigating their traditional dispute resolution function.
Also national courts, in civil law countries, increasingly contribute to the achievement of the goals of conduct regulation. The EU pre-crisis regulatory technique, based on the

harmonization of right-conferring rules, led, *de facto,* to introduce in continental jurisdictions, via courts, a higher standard of protection for retail clients than that foreseen in conduct of business rules. By contrast, in the UK, national courts have firmly defended the autonomy of common law against the inroads of EU regulatory standards, especially in non-advised transactions. However, the EU regulatory standards play a stronger role in the out-of-court dispute resolution, managed by the FOS,[935] which decides most of the retail clients disputes.

[935] See SRM Regulation and BRRD and recital no 30 of the SSM Regulation.

Part III: THE EU INSTRUMENTALIZATION OF NATIONAL PRIVATE LAW AND ENFORCEMENT

Setting the scene

The Part III of the thesis aims to assess the conceptual and legal implications of the substantive and enforcement changes examined in Part I and II. The main argument is that the EU investor protection regulation and EU and national enforcement mechanisms have determined the Europeanization and instrumentalization of national private law; namely, they have transformed private law and enforcement from instruments to protect the autonomy of private parties into instruments to ensure the fulfillment of the objective of EU investor protection regulation and the other objectives of EU financial regulation.

To demonstrate this argument, Chapter 7 identifies, on the basis of the earlier findings, the three fundamental conceptual models of interaction between EU investor protection regulation (separation, substitution and hybridization) and argues that the model of hybridization better reflects the level and nature of the interactions between EU finacial regulation and national private law. Chapter 8 examines whether the model of hybridization is legitimate and appropriate from the perspective of EU law, considering the principles of effectiveness and effective judicial protection, and EU fundamental rights. Finally, Chapter 9 summarizes the earlier findings and draws the main implications of the instrumentalization of national private law.

Chapter 7 –TOWARDS THE HYBRIDIZATION OF NATIONAL PRIVATE LAW AND ENFORCEMENT

1. From the 'Europeanization' to the 'instrumentalization' of national private law

This foregoing confirms the wider phenomenon, observed also in other sectors of the internal market, of the 'Europeanization' of national private law, namely of the influence of EU law on national law, not only through formal top-down legislative

harmonization, but also through forms of bottom-up quasi-harmonization, based on judicial and administrative acts.[936] The Europeanization, triggered by the EU pre-crisis regulatory approach, has been strengthened after the financial crisis.

The pre-crisis EU investor protection regulation, albeit not expressly harmonising the national private laws governing financial transactions, influenced the judicial interpretation and enforcement of national private law. National courts, in continental jurisdictions, have deployed the EU-derived standards of conduct to upgrade their national private law remedies, thus overcoming a formalistic and dogmatic interpretation of national private law categories. With regard to the UK, the discourse is more complex and articulated. Whilst the legal doctrine has recently underlined an ongoing gradual trend towards the Europeanization of tort law,[937] the foregoing has indeed shown the resistance of many UK courts to the EU financial regulation which could lead actually determine or consolidate the "non-Europeanisation" of UK common law.[938] However, a broader institutional view to the UK legal system reveals that the Europeanization is emerging from the out-of-court dispute resolution: the FOS adjudicates the large majority of retail client disputes, is not bound by common law, and gives more prominence than courts to the EU-derived regulatory standards.

The EU post-crisis reforms have increased the influence of EU law on national private law by shifting the location of supervisory and, consequently, judicial powers. Supervisory acts, previously adopted at the national level, will be taken at the EU level, where supranational elements such as, above all, financial stability, will come into play. Consequently, this will increase the involvement of the Union

[936] See in particular R. Michaels and N. Jansen. 'Private Law Beyond the State? Europeanization, Globalization, Privatization'. Duke Law School Legal Studies Research Paper Series Research Paper No. 137 (2007): 19.

[937] See P. Giliker. T*he Europeanisation of English Tort Law, Oxford:* Hart, 2014, p. 210.

[938] See L. Niglia. "The non-Europeanisation of Private Law" 4 European Review of Private Law (2001): 575. See, in more detail for the concept of resistance in EU private law, H. Muir Watt. 'Conflict and Resistance – The National Private Law Response' in H.-W. Micklitz, Y. Svetiev. '*A Self-Sufficient European Private Law – A Viable Concept?*' EUI Working Papers LAW 2012/31 DEPARTMENT OF LAW European Regulatory Private Law Project (ERPL - 01) European Research Council (ERC) Grant and G. Comparato. *Nationalism and Private Law in Europe*, London: Bloomsbury, 2014, p. 156.

courts in judicial review as well as in preliminary rulings. In addition, the EU post-crisis reforms conferred new, incisive, powers on supervisory authorities to interfere with private law relationships, namely in the making of contracts (through soft-law instruments) and in their enforcement (through ADRs). The ADRs represent the most important example of Europeanization through the institution-building capacity of the EU. The MiFID I, ADR Directive and MiFID II have gradually transformed ADR into a central (and mandatory, for Member States) element of the retail financial market regulation which aims not only at resolving informally disputes but also at ensuring the effectiveness of conduct of business rules, thus complementing the supervisory action of the EU and national supervisors.

It is submitted that the infusion of national private law and enforcement with the EU regulatory objectives changes the function of traditional private law, transforming it from an instrument to ensure the autonomy of market participants to an instrument to ensure that this autonomy in contract-making and enforcement does not contrast with the objectives of EU financial regulation. The question arises as to how this instrumentalization of private autonomy should be conceptualized, and if and how it can be legally justified on the basis of EU law.

This chapter aims to answer the first question and to offer a better understanding of how EU investor protection regulation can influence national private law by drawing on the findings of the earlier comparative and institutional analysis. The main argument is that, after the global financial crisis, the EU and national legal orders are moving from a traditional separation model – based on the distinction between autonomy and regulation – towards an hybridization model in which financial regulation becomes the yardstick to interpret national private law remedies and procedures.

2. The varieties of the instrumentalization

Building on the methodology of the ERPL project,[939] recently pursued by Olha O. Cherenychenko,[940] this chapter identifies three fundamental models of interaction (i.e. separation, substitution and hybridization) that reflect different regulatory, supervisory and enforcement approach followed by the EU in investor protection regulation.

The purpose of the models of interaction is threefold. First, these models aim to show and explain how EU investor protection regulation, often considered as a foreign body in national private law, does indeed influence contract making and enforcement, through different institutional mechanisms and beyond the formal, top-down legislative harmonization. Notably, the models are designed from the perspective of EU law and therefore they do not consider the possible interferences of national law into EU law. Second, the models seek to bring together the different 'strings' of Europeanization in order to offer a more organic view of how the different institutions shape national private law. The models, however, should not be seen as an attempt to systematize the 'un-systematic', multi-level and sectoral-based nature which characterizes EU private law.[941] Rather, these models presuppose a pluralistic view of private law, ' where each institution responds to a different regulative principle, namely: vindicates a distinct balance of values and a distinct set of purposes suitable for its particular subject matter'.[942] For this reason, it is possible that several models co-exist in the same legal system because of different regulatory strategies in different segments of the markets (i.e. retail and non-retail) and because, within the same legal system, regulatory choices driven by certain objectives may be orientated towards different objectives 'off the books', by courts and adjudicators. Third, whilst these models of interaction have a primary descriptive function, they serve also as a theoretical basis to evaluate the legitimacy and appropriateness of the EU intervention on private law relationships.[943]

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[939] See chaper 1, above.
[940] See O. O. Cherednychenko. 'Contract Governance in the EU', 508 who identifies four models of interaction: substitution, separation, complementarity and integration.
[941] H.-W. Micklitz. 'The (Un)-Systematics of (Private) Law as an Element of European Culture.' in G. Helleringer and K. Purnhagen (eds.). *Towards a European Legal Culture*, Nomos Verlagsgesellschaft, Verlag C.H. Beck and Hart Publishing, 2014.
[942] See H. Dagan. 'Autonomy, Pluralism and Contract Law Theory' 76 Law and Contemporary Problems (2013): 20.
[943] See Chapter 8, below.

3. Models of interaction between EU investor protection regulation and national private law

3.1. Separation

A) Concept

The model of separation means that regulatory duties and private law duties co-exist in parallel and apply to the transaction within their 'respective fields of competence', without interferences.[944] Under this model, financial regulation (and regulation in general) should be a foreign body for private law. Whilst regulation aims to achieve the public interest, private law aims to ensure the private interest, namely the autonomy of market participants. This model posits also a clear separation between the tools of regulation (statutory remedies) and that of private law (general contract and tort law).

In fact, the model of separation, does not preclude individuals from enforcing regulatory standards but it requires individuals to enforce them through express statutory remedies which are specifically-designed, *ex ante*, by regulators to balance the need of deterring misconduct with that of avoiding strategic litigation especially among professionals. By contrast, this model firmly precludes the creation of implied private law remedies, either in contract (through incorporation of regulatory duties into contract terms) or tort (through the imposition on firms of the general duty of care), for the firm's breach of regulatory duties. The main advantages of this two-tiered model is that it ensures a high degree of legal and commercial certainty and it favours parties' autonomy and contract innovation; a two-tiered model establishes a perfect complementarity between autonomy and regulation.[945] However, the flip-side of complementarity is the conflict between regulation and private law.[946] Not only a separation model risks discarding the role

[944] See, for this view, A. Hudson. *Law of Finance*' 39 and I. H.-Y. Chiu. 'Regulatory Duties for Directors in the Financial Services Sector and Directors' Duties in Company Law: Bifurcation and Interfaces' 6 Journal of Business Law (2016): 489.
[945] See O. O. Cherednychenko. 'Contract Governance in the EU', 512.
[946] G. Comparato. *Nationalism and Private Law in Europe*, 156.

of contract law as a tool to achieve other public interest goals but it also limits the possibility for national courts to interpret national law in light of EU regulatory standards and, consequently, it casts doubt on its capacity to fully ensure the effective protection of the EU-derived rights.

B) Regulation

Financial regulatory duties can be separate from private law duties either through a positive or a negative regulatory technique. The first technique consists in granting the investors an express specific statutory remedy for the breach of conduct regulation. For example, the § 10(b) of the US Securities Exchange Act of 1934 and the Section 138 of the FSMA introduced a specific statutory cause of action with the original aim to increase deterrence and compensation, beyond the traditional general private law remedies.[947]

The other regulatory technique is to prevent regulation from interfering with private law and vice versa. For example, the Directive 2005/29/EC on unfair Commercial Practices specifies that its provisions apply 'without prejudice to contract law and, in particular, to the rules on the validity, formation or effect of a contract' (Article 3(2)).[948] In EU financial law, this approach has been adopted, before the financial crisis, by the Commission MiFID I Directive which laid down the principle of the non-interference between conduct regulation and contract law duties (recital No 41). However, whilst the Commission's intention could well have been to avoid interference between regulation and private law, other provisions of the MiFID as well as the judicial approach of national courts have triggered the hybridization of national private law. After the financial crisis, the regulatory technique of separation has been used by the CRD IV, which specifies that its requirements for the suitability of board members should not interfere with national company law (recital No 55) and by the EMIR, which specifies, that the infringement of certain rules cannot give rise to the avoidance of contract or any

[947] See the theory of the implied rights of action under § 10(b) of the Securities Exchange Act of 1934 of Joseph A. Grundfest. 'Damages and Reliance Under Section 10(b) of the Exchange Act' Stanford Law School and The Rock Center for Corporate Governance August 28, (2013).
[948] Directive 2005/29/EC of the European Parliament and of the Council of 11 May 2005 concerning unfair business-to-consumer commercial practices in the internal market an OJ L 149/22 (2005).

right to compensation (Article 12(3)).

C) Supervision

In supervision, the model of separation would require supervisors to be concerned only with the protection of public goals (financial stability, consumer confidence) rather than the direct or indirect regulation of firm-client transactions. The underlying assumption is that market participants should be left free to decide the terms of their transactions and these transactions should be regulated by private law. This conception can reflect (i) the institutional supervisory setting (for example, on the prioritizing financial stability-related objectives over consumer protection objectives); (ii) the scope and significance of the consumer-protection mandate (for example, it could concern the protection of the broad value of consumer confidence or, more prescriptively, the contractual individual rights of the client vis-à-vis the firm); and (iii) the type of supervisory powers (for example, *ex post* sanctioning of misconduct, rather than *ex ante* regulation of financial products).

In addition, in order not to interfere with transactional or private law-related issues a model of separation distinguishes the dispute resolution from the supervisory functions. An example could be the facilitative ADRs, examined in the French jurisdiction, in which the resolution of individual disputes is merely considered as a private issue with no implications for financial supervision.[949] However, overall, after the crisis, this supervisory model is not widespread in the examined jurisdictions, including the UK where, as I have shown above, the FCA has indeed very intrusive powers to interfere with contractual relationships, through its consumer protection powers and product intervention powers.

D) Enforcement

In the model of separation there is a clear distinction between private and public enforcement, and, between contract enforcement and conduct regulation

[949] See Y. Svetiev and A. Ottow. 'Financial Supervision in the Interstices Between Private and Public Law', 527.

enforcement. Separation should be understood as non-interference between the enforcement of contract terms, driven by compensation, and entrusted to courts, and enforcement of regulatory standards, driven by the public interest goals i.e. in protecting clients' confidence, deterrence, and entrusted to ADRs. Separation, does entail a minimum degree of coordination between these different kinds of (judicial and extra-judicial) enforcement mechanisms to make sure that the division of competences and the respective powers of courts and ADRs is clear.[950] From the perspective of private enforcement, such a legal model, expressed by UK division between courts and FOS, is effective in driving, ex ante, the plaintiffs either to courts or to the FOS but risks exacerbating the bifurcation between retail unsophisticated investors, who have access to the FOS (up to £ 150,000) and sophisticated investors who do not.

3.2. Substitution

A) Concept

At the other extreme of the separation model, lies the model of substitution. In this model, the EU regulatory objectives and tools overrid the national private law ones. In practice, the most important effect of substitution is that national law (and national courts) cannot impose more stringent private law duties and remedies than those provided for by EU law.

The main advantage of the substitution model is that it ensures a high degree of uniformity across national jurisdictions, ensures that private law rules are aligned with the expertise of regulators. However, on the other hand, the substitution model carries significant risks because it restricts regulatory competition, makes the regulatory framework inelastic and reduces the protection that clients would have enjoyed under general private law, giving the impression that EU law is 'a shield and never a sword'. [951]

[950] O.O. Cherednychenko. 'Public and Private Enforcement of European Private Law in the Financial Services Sector' 4 European Review of Private Law (2014): 641.
[951] See O. O. Cherednychenko. 'Contract Governance', 511.

B) Regulation

The model of substitution can be introduced either by way of maximum harmonization directives or Regulations. After the global financial crisis, the EU has increasingly used the instrument of the Regulation, particularly in prudential regulation, with the declared objective to reduce regulatory complexity and investment firms' compliance costs,[952] eliminate competitive distortions,[953] to ensure a level playing field between market participants, also regarding specific obligations imposed on private parties.[954] More importantly, the CRA, EMIR and PRIIPs Regulations have introduced limitations to the national tortious remedies, *de facto* carving out higher standards of protection than granted by national private law.[955] A similar 'pre-emptive' mechanism has been observed in the field of consumer law with regard to the Directives, which introduced maximum harmonization standards based on the model of the consumer "who is circumspect and responsible".[956] In both cases, these substitution effects restrict the margin of manoeuvre of Member States. But whereas in consumer law the substitutionary effect was based on the assumption that the prevention of higher national standards of protection would facilitate cross-border transactions,[957] in financial regulation the (implicit) assumption is that higher standards of protection could increase vexatious litigation, thus jeopardizing the stability of the financial system. Restricting private law remedies to increase financial stability, lacking a legal basis enabling the EU to legislate to strengthen financial stability, raises crucial issues of competence.

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[952] See recital No 12 of Regulation (EU) No 575/2013 on prudential requirements for credit institutions and investment firms ('CRR') O.J. L 176/1 (2013); recital No 5 of Regulation (EU) No 596/2014 on market abuse (MAR) O.J. L 173/1 (2014); recital No 5 of MiFIR.
[953] See recital No 12 of the CRR; Recital No 5 of MiFIR.
[954] See recital No 3 of Regulation (EU) No 648/2012 on OTC derivatives, central counterparties and trade repositories (EMIR) O.J. L 201/1 (2012); recital No 5 of MAR.
[955] For the theory of pre-emption see See A. Arena. 'Exercise of EU Competences and Pre-emption of Member States' Powers in the Internal and the External Sphere: Towards 'Grand Unification'?' 35 Yearbook of European Law (2016): 28; J. H. H. Weiler. 'The Community system: The dual character of supranationalism' 1 Yearbook of European Law (1981): 277; T. Tridimas. 'Competence after Lisbon. The elusive search for bright lines', in D. Ashiagbor, N. Countouris, I. Lianos. 'The European Union after the Treaty of Lisbon', Cambridge: Cambridge University Press, 2012, p. 64.
[956] See H.- W. Micklitz. '*Social Justice and Access Justice in Private Law*' 20.
[957] See in particular H.-W. Micklitz. "The EU as a Federal Order of Competences and the Private Law" in L. Azoulai. "The Question of Competence in the European Union", Oxford: Oxford University Press, 2014, p. 125.

Is Article 114 of the TFEU, which underpins the CRA, EMIR and PRIIPs Regulations, the appropriate legal basis to harmonize national private laws with the aim of achieving financial stability?

In the absence of a specific EU legal basis for the harmonization of private law, the 'purposive driven' character of Article 114 has been instrumentalized to harmonize private laws, on the assumption that the harmonization of private laws strengthens the internal market.[958] The recourse to Article 114 to achieve financial stability, however, requires a double instrumentalization. Since the harmonization (or limitation) of private law remedies ensures financial stability, and financial stability is the pre-condition to ensure market integration,[959] the harmonization of national private laws determines a higher level of market integration. In the landmark short-selling case the CJEU, by endorsing the validity of Article 114 of TFEU as a legal basis for the ESMA power to ban short-selling, implicitly endorsed this double-instrumentalization.[960]

The CJEU started from the premise that the main rationale of the short-selling bans and restrictions is to mitigate systemic risks (Article 1) and considered that 'Member States had in place divergent requirements and powers related to short-selling'; therefore, the CJEU concluded that 'the harmonization of the *rules governing such transactions* [short selling and credit default swaps] is intended to prevent the creation of obstacles to the proper functioning of the internal market and the continuing application of divergent measures by Member States.'[961]

In conclusion, Article 114 TFEU, read in light of this judgment, could be regarded as an appropriate legal basis also to harmonise private law remedies even when the

[958] See S. Weatherill. 'Competence and European Private Law' in C. Twigg Flesner (ed.). The Cambridge Companion to European Union Private Law, Cambridge: Cambridge University Press, 2010, p. 58 .

[959] See in particular recital No 31 of ESRB Regulation and recital No 17 of ESAs Regulation. See also referring to financial stability as an objective which is 'closely linked' to the objectives of the Union *acquis* concerning the internal market for financial services'

[960] Case C-270/12, UK vs European Parliament and the Council, ECLI:EU:C:2014:18.

[961] Case C-270/12, UK vs European Parliament and the Council, para 114.

proximate objective of harmonization is financial stability and not client protection. However, this purposive reasoning transforms Article 114 TFEU in an open-ended norm, with evident risks for the principles of democracy and legitimacy.[962] The EU legislators have the responsibility to motivate expressly the reasons why financial stability is instrumental to achieve stronger integration and why private law is the right tool to achieve this objective, taking into account the principles of subsidiarity and proportionality.

C) Supervision

In supervision, the model of substitution entails that supervisor can interfere with the creation and enforcement of contracts (i.e. by pre-approving financial instruments or vetting financial instruments, thus terminating the parties obligations) and, more importantly, that they can drive the private enforcement of financial regulation. The normative reason to entrust supervisors with this incisive power is to ensure an optimal level of deterrence. This is necessary when the plaintiff does not have enough incentives to sue (rational apathy) or when, by contrast, the private benefits of litigation outweight the social ones, thus creating over-deterrence. To remedy the under-deterrence, some authors propose giving private enforcement powers to supervisory authorities (like the US SEC),[963] or, like in the field of EU competition law, requiring national courts to conform their judgments to the decisions taken by supervisors.[964]

These mechanisms would ensure that the institutional actor holding most information about financial firms has the power to choose when to act and how to act to ensure the effective protection of clients.[965] To remedy over-deterrence, supervisors could be granted the last resort power to pre-vetting 'obviously

[962] G. Davies. 'Democracy and Legitimacy in the Shadow of Purposive Competence' 21 European Law Journal (2015): 2-22.
[963] See H. E. Jackson, M. J. Roe. 'Public and private enforcement of securities laws: Resource-based evidence' 93 Journal of Financial Economics (2009): 207-238.
[964] See Council Regulation (EC) No 1/2003 of 16 December 2002 on the implementation of the rules on competition laid down in Articles 81 and 82 of the Treaty (Text with EEA relevance) OJ L 1/1 (2003) and Directive 2014/104/EU of the European Parliament and of the Council of 26 November 2014 on certain rules governing actions for damages under national law for infringements of the competition law provisions of the Member States and of the European Union OJ L 1/349 (2014).
[965] See J. M. Glover. 'The Structural Role of Private Enforcement Mechanisms in Public Law' 1182.

vexatious or ill-motivated litigation' between professional investors.[966] However, there is a risk that such pre-vetting excessively reduce the private parties rights, making private enforcement subject to the same risks of capture which generally characterizes public enforcement. [967]

D) Enforcement

In private enforcement, the model of substitution means that national courts and ADRs cannot impose private law duties or remedies that are stricter than regulatory duties. This effect will be triggered the new liability regimes of the CRA, PRIIPs and EMIR Regulations, which arguably will carve out the higher standards of protection based on national law. With respect to the MiFID conduct rules, which *stricto iure* do not impose maximum standards, a substitution effect has indeed not yet materialized in the examined jurisdictions. This substitution effect would indeed be detrimental for the protection of investors because it would make investors "wholly dependent on the regulatory system of protection, however imperfect and inflexible it may prove to be".[968] On the other hand, tt could be argued that such 'regulatory dependence' is not necessarily detrimental for the consumer. After all, some regulatory standards, such as the MiFID fair treatment clause, reflect private law duties (i.e. pre-contractual good faith) enshrined in civil law countries. However, whilst the private law general duties apply 'horizontally' to all contractual relationships, irrespective of the nature of the good and service and the nature of the party, the MiFID standards apply 'vertically', in so far the transactions concerns investment services and activities provided for by authorised firms. Therefore, a judicial interpretation that makes the private law remedy subject to the applicability of the MiFID standards would inevitably restrict the scope of private law remedies and incentivising abusive business practices to circumvent the MiFID's and the private law standards of protection.

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[966] See M.Andenas and I. Chiu. *The Foundations and Future of Financial Regulation, p.* 225.
[967] See in particular D. F. Engstrom. 'Public Regulation of Private Enforcement: Empirical Analysis of DOJ Oversight of Qui Tam Litigation under the False Claims Act '107 Northwestern University School of Law Review (2013): 1690
[968] O. O. Cherednichenko. 'Contract Governance', 511.

3.3. Hybridization

A) Concept

Hybridization is the general normative model for the composite, multi-layered EU legal order.[969]Although legal hybrids are vague concepts, usually used when "our inherited conceptual framework is unable to capture and imprison in a determined conceptual box",[970] in EU law the concept of hybridization has acquired a precise meaning. It refers to the not exclusively national nor European (and thus hybrid) nature of the private law remedies and procedures specifically aimed at protecting the EU-derived rights. Such remedies, whilst formally based on national law, do not only have to be equivalent and effective but also to be adequate or sufficient to ensure the effective protection of these rights. This adequacy or sufficiency standard can also result in the broadening of existing remedies or the introduction of new ones, when necessary to ensure effective protection.[971] Through this upgrading effect, the former national remedies become hybrid remedies.

Therefore, whereas substitution is an outcome and regulatory-driven model because the regulators decide *ex ante* the private law consequences of the breach of regulatory requirements, hybridization is a process and enforcement-driven model, because it leaves to supervisors, ADRs and courts (enforcement institutions) the task of adjusting, *ex post,* private law remedies and procedures in order to achieve EU regulatory objectives. It should be noted, however, that in the hybridization model the traditional *ex post* character of adjudication is somehow softened by the fact that the judge interprets private law concepts in light of regulatory standards intended to steer, *ex ante*, the conduct of market participants.

From a normative perspective, the elasticity of the hybridization model seems to better balance autonomy and regulation as well as EU and national institutions, avoiding the potential resistance due to the prevalence of one

[969] H.-W. Micklitz. 'Monistic Ideology versus Pluralistic Reality – Towards a Normative Design for European Private Law' in L. Niglia (ed.), Pluralism and European private law, Oxford: Hart, 2013, p. 47.

[970] See, in particular, K. Tuori. 'On legal Hybrids and Perspectivism' in M. Maduro, K. Tuori, and S. Sankari. *Transnational Law: Rethinking European Law and Legal Thinking*, Cambridge: Cambridge University Press, 2014, p. 14.

[971] See Chapter 8, below.

regulatory/institutional layer over the other.[972] However, the Achilles' heel of this model is that, precisely because it relies on *ex post* judicial assessment conducted with general and vague concepts, it could increase legal and commercial uncertainty.[973] To overcome this important objection, it is necessary to better clarify how the hybridization effect can be legally grounded in the general principles of EU law.[974]

B) Regulation

The hybridization effect is driven by the EU's decision to introduce, via Article 114 of the TFEU, minimum standards of protection (generally covering right-conferring rules and/or constitutive remedial conditions) in order to leave the Member States free to introduce higher standards of protection. The minimum harmonization technique has underpinned the first generation of EU conduct of business rules, introduced by the ISD, and, although the issue is still debated, the second and third generation of conduct of business rules laid down by the MiFID I and MiFID II. In fact, it is submitted that, even if the MiFID I and MiFID II, ensure "a high level of investor protection to be applied in a uniform manner" (recital No 5 Commission MiFID I Directive), they cannot be technically regarded as maximum harmonization directives.

Although the absence of the 'maximum harmonization clause' does not indicate *per se* that the Directive introduces a minimum harmonization regime,[975] the purpose of the MiFID (i.e. efficiency of the financial market and investor protection) provides no clear evidence that the Directives intended to prevent national higher

[972] See O. O. Cherednychenko. 'Contract Governance', 513.
[973] See J. A. Grundfest. 'Damages and Reliance Under Section 10(b) of the Exchange Act', 25who argued that the creation of implied rights of action under Section 10(b) of the 1933 Securities Act is 'is entirely a creature of the judicial imagination, and it comes as no surprise that the courts have played a crucial role in the evolution of Section 10(b) jurisprudence.'
[974] See Chapter 8, below.
[975] See for this conclusion with regard to the Product liability Directive: Case C-154/00, *Commission v Hellenic Republic* [2002] ECLI:EU:C:2002:254, para 12; Case C-402/03 *Skov and Bilka* ECLI:EU:C:2006:6, para 22; Case C-52/00 *Commission v France* ECLI:EU:C:2002:252, para. 16; Case C-183/00 *Sánchez v Medicina Asturiana SA* ECLI:EU:C:2002:255, para 25 and regarding the Market Abuse Directive the Opinion of AG Kokott, C-45/08, Spector Photo Group NV, ECLI:EU:C:2009:534, para 84.

standards for client protection.[976] The MiFID II further allows Member States to retain or impose additional requirements in exceptional circumstances and, in particular, to address 'specific risks to investor protection' (Article 24(2)). Notably, the MiFID II has moved this provision from Level 2 to Level 1, thus showing the intention of the EU legislator to give to Member States a broader margin of manoeuvre in conduct of business rules matters in comparison to the other matters regulated by the Directive.

C) Supervision

In supervision, the model of hybridization entails that supervisory powers should interfere with the interpretation and enforcement of the contractual obligations when this is necessary for the fulfillment of the consumer protection or financial stability mandates. Notably, this form of interference is less strong than in the separation model because it does not prevent private parties from entering into transactions nor does it pre-vet private enforcement actions. Instead, it incentivizes private parties, through quasi-regulatory acts, to conform their contracts to regulatory duties and to exercise their private enforcement right in coordination with supervisory acts (so called 'supervisory private law').[977]

A clear example of coordination is Article 85(3) of the BRRD, which requires Member States to ensure that national courts use the complex economic assessments of the facts carried out by the resolution authority as a basis for their own legal assessment. Similarly, French law expressly allows the national judge to request the AMF to transmit files of its investigations if the files are relevant for the disputes.[978]

Differently from the substitution models of pre-vetting, these patterns of

[976] See in favour of the full harmonization: P. O. Mülbert. 'The Eclipse of Contract Law in the Investment Firm-Client- Relationship, p. 299. Against the maximum harmonization: O. O. Cherednychenko. 'Full Harmonisation of Retail Financial Services Contract Law in Europe: A Success or a Failure?', in S. Grundmann and Y. M. Atamer (eds.). Financial Services, Financial Crisis and General European Contract Law, p. 243.

[977] See O. O. Cherednychenko. 'Public Supervision over Private Relationships', 37 and Y. Svetiev and A. Ottow. 'Financial Supervision in the Interstices Between Private and Public Law', 496.

[978] Law No 2014-344 of 17 March 2014 on consumer law, Art. L 621-12-1.

coordination leave the court free to interpret the law, irrespective of the decision of the supervisors, and therefore to hand down a judgment that can be conflict with the supervisory decision. If a similar model were to be extended to the MiFID, it would, for example, allow a client who had suffered a loss caused by the firm's failure to respect its conduct of business rules to invoke in a civil proceeding the supervisory measure that restricted or affected that product or practice, in order to ask the court for the alleviation of his or her burden of proof against the firm. However, whilst national courts, as a principle, are always free to consider supervisory acts as evidential elements to prove the facts, they are not required to do so. To this end, a specific legislative provision is needed.

D) Enforcement

Private enforcement is the most important vehicle for the hybridization of national private law because it allows judges and adjudicators to decide, *ex post*, how to design private law remedies considering financial regulatory standards. In this sense, hybridization is a form of 'regulation of private enforcement'. The dispute is no longer decided based on the parties' individual interests (defended by traditional contract law) but on the basis of the public interest (defended by regulations). The US Federal Courts has also underlined that private enforcement, through the implied rights of action under Section 10(b) – which can be seen as the precursors of the EU/national hybridized remedies – have the purpose of ensuring the objectives of financial regulation.[979]

Similarly, in Italy, Spain and France courts interpret national private law concepts (e.g. good faith) in light of the purpose and wording of the EU conduct of business regulation in order to achieve the investor protection objective through general private law. This has led to the result – which would be prevented into a separation model – that private law duties and remedies can be stricter than regulatory duties. As a matter of fact, this capacity of private law to expand the protective scope of the EU regulatory duties, seems to increase in the legal systems that have elected not to

[979] See M.C. Stephenson. 'Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies' 91 Virginia Law Review (2005): 103.

give investors special statutory remedies. In fact, such special statutory remedies, as shown by the UK case law, can backfire the investors because they confine their private law rights of action to the statutory remedies thus barring them from relying also upon general private law remedies.[980]

Finally, in most of the examined jurisdictions the extra-judicial private enforcement is integrated within the supervisory authorities. The main implication of this 'institutional integration' is that ADR, traditionally meant to resolve disputes informally based on the parties' pre- and post-contractual conduct, adjudicate disputes on the basis of financial regulatory standards adopted or endorsed by the supervisory authorities. The trend towards the integration of this dispute resolution function into the supervisory function will be further increased by the ADR Directive which requires Member States to establish mechanisms of cooperation between ADRs and consumer authorities, which shall include 'mutual exchange of information and the provision of technical assessment and information by such national authorities to ADR entities where such assessment or information is necessary for the handling of individual disputes and is already available' (Article 17).[981]

[980] See however the UK Law Commission, *Fiduciary Duties and Regulatory Rules*, Law Com no. 236 (Law Commission 1995) 84 which held that 'that the 'hybrid model' would reconcile the traditional private law approach with the public law one [...] Under this, some recognition would be given to the public law nature of the regulatory rule by taking account of it when determining the content of the fiduciary obligation.' Although it was our view that where the scope of a rulemaking power was uncertain, the hybrid model probably represented the law.'

[981] See ESMA. Response to the Commission Green Paper on Retail Financial Services. 21 April 2016. ESMA/2016/648, p. 7 (footnote n. 8).

Chapter 8 – THE HYBRIDIZATION OF PRIVATE LAW IN EU CASE LAW AFTER THE GLOBAL FINANCIAL CRISIS

1. The challenges of the hybridization

The model of hybridization has described the scope, intensity and nature of the interactions between EU investor protection regulation and national private law after the financial crisis. However, this model poses significant theoretical and operational challenges. The most important question that arises is whether this model of interaction can be legally justified on the basis of EU law and more precisely whether, in the absence of EU law provisions harmonizing national private law duties and remedies, EU law could justify the imposition on financial firms of private law duties and liability that are stricter that the EU conduct of business rules.

Morever, since the model of hybridization entails the introduction of regulatory goals in private law adjudication, a crucial question arises as to how these goals should be balanced when there is a potential conflict between them. In mis-selling disputes, such balance indeed could lead to the client being empowered with hybrid (or upgraded) private law remedies, to strengthen the dissuasive effect of EU conduct rules, or to the contrary, to limit its private law remedies, to preserve the safety and soundness of financial firms with a view of protecting the stability of the financial system.

In addition to this, the model of hybridization, unlike that of separation and substitution, relies on the combination between EU right-conferring provisions and their national implementation, through administrative standards, court's judgments and ADR's decisions. From an operational perspective, this 'combination' risks increasing the legal and commercial uncertainty and therefore requires a conceptual elaboration to better understand its functioning, scope and limits.

To this end, this chapter seeks to explain why the model of hybridization is legitimate and appropriate in the EU legal order. It is argued that this form of EU intervention in private law relationships is legally justified by the principle of conform interpretation, the principle of effectiveness and the EU fundamental rights. These principles – it is submitted – strengthen the horizontality of EU conduct of business rules; namely their capacity to drive the interpretation of national private law remedies and procedures, and consequently, contribute to the attainment of an appropriate level of compensation and deterrence in EU retail financial markets.[982]

2. The 'horizontality' of EU investor protection regulation

2.1. Horizontal direct and indirect effects

The key question to be addressed is how the MiFID conduct rules, which *stricto iure* do not harmonize national private law remedies, can, nevertheless, lead to the judicial conferral of new remedies in favour of the investor (and conversely, to the imposition of liability to the firm). This question intersects the vexed issue of the horizontality of EU law provisions. To address it, it is however important to distinguish the EU law provisions which can be merely invoked in civil proceedings (horizontal effects *stricto sensu*) and those which can also give an implied remedy to the client for the firm's breach of conduct of business rules.

The starting point is the distinction between direct and indirect horizontal effects. The notion of direct effect indicates the effect of certain EU law provisions that are clear, precise and unconditional enough to be invoked and relied upon by individuals before national courts.[983] According to settled case law, whilst the

[982] This chapter does not consider the question on what level of private enforcement is appropriate. See in this regard S. Shavell. "*The Social versus the Private Incentive to Bring Suit in a Costly Legal System"* 11 The Journal of Legal Studies (1982): 333 (1982); L. Kaplow. '*Private versus Social Costs in Bringing Suit'* 15 The Journal of Legal Studies (1986): 371; S. Shavell. 'The Fundamental Divergence between the Private and the Social Motive to Use the Legal System', 16 The Journal of Legal Studies (1997): 599.

[983] See, in particular, T. Tridimas. 'Black, White, and Shades of Grey: Horizontality of Directives Revisited' 21 Yearbook of European law (2001): 328, S. Prechal. *Directives in EC Law*, p. 216 and 'P. Craig. 'The nature and effect of EC law: direct effect and beyond' in P. Craig, G. De Búrca (eds.). EU

provisions of the Treaties, Regulations and Decisions can be invoked against the state (vertical effect) and private parties (horizontal effect), the provisions of Directives can be invoked only against the state[984] but not directly against other private parties.[985]

However, horizontal effects can be direct and indirect. Horizontal direct effects entail that EU law is the only source governing the parties' relationship; namely, by modifying, suspending or terminating the terms of a contract or by labelling a private act as illicit ('substitution effect').[986] Horizontal direct effects derive from the provisions of the EU Treaties, Regulations and Decisions, supervisory decisions (i.e. product intervention) but cannot derive from the Directive's provisions because this would be tantamount of transforming Directives in directly applicable acts, bypassing national law.[987]

2.2. The conform interpretation of national law

Directives can (only) produce indirect horizontal effects, namely by opposing the application of conflicting national rules applicable to the private relationship ('exclusionary effect')[988] and by ensuring that national law is interpreted in conformity with EU law.[989] Whilst in the examined continental jurisdictions it is well accepted that national private law should be interpreted in light of the EU conduct of business rules, in the UK the issue is debated.[990]

It must be remembered that the CJEU extended this duty, intially affirmed in relation to unimplemented directives, to directives that were adequately

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Law: *Text, Cases, and Materials*, 6th ed., Oxford: Oxford University Press, 2015, p. 268.

[984] See case C-41/74, *van Duyn*, ECLI:EU:C:1974:133 and case C-148/78, *Ratti*, ECLI:EU:C:1979:110.

[985] See inter alia, case C-152/84, *M. H. Marshall*, ECLI:EU:C:1986:84.

[986] See C. Timmermans. '*Horizontal Direct/Indirect Effect or Direct/Indirect Horizontal Effect: What's in a Name?*' 4 European Review of Private Law (2016): 677. Directives, instead, can produce vertical effects, if the deadline for their transposition expired.

[987] See, in particular, P. Craig. 'The legal effect of Directives: policy, rules and exceptions' 34 European Law Review (2009): 352.

[988] See case C-194/94, *CIA Security*, ECLI:EU:C:1996:172 and case C-443/98, *Unilever*, ECLI:EU:C:2000:496.

[989] See, in particular, C. Timmermans. '*Horizontal Direct/Indirect Effect or Direct/Indirect Horizontal Effect: What's in a Name?*', 678 and A. Hartkamp, *European Law and National Private Law,* Alphen aan den Rijn: Wolters Kluwer, 2012, ch.4.

[990] See in particular *Grant Estates Limited vs RBS* [2012] CSOH 133 CA152/11, para 47.

implemented into national law.[991] In addition, the CJEU required national courts to take into account not only the national provisions transposing the Directive but also the "the whole body of domestic law into consideration".[992] The duty to conform interpretation is, however, limited in two respects. First, it cannot lead to a *contra legem* interpretation of national law;[993] second, it cannot result in the aggraviation or imposition of criminal liability on the individual.[994] However, in *Centrosteel*, the Advocate General Jacobs recognized that the interpretation of national law "may well lead to the imposition upon an individual of civil liability or a civil obligation which would not otherwise have existed".[995] Similarly, in *Océano,* the CJEU, contrary to the opinion of Advocate General Saggio,[996] decided that the national judge can (not must) assess *ex officio* the unfairness of a contract term even if national law does not expressly contain this procedural remedy.[997]

It could be argued, therefore, that there must be a strong link between the conduct of business rules and a national private law remedy in order for this remedy to be interpreted in light of the duty of conduct. For sectoral statutory remedies (e.g. Section 138 of the FSMA), which are specifically designed to enforce financial regulation, the CJEU case law mentioned above seems to indicate that the national

[991] See Case C-386/00, *Axa Royale Belge SA* ECLI:EU:C:2002:136, para 71.
[991] See Case C-268/06, *Impact* ECLI:EU:C:2008:223, para 100.
[991] See Opinion AG Jacobs in Case C-456/98 *Centrosteel*(unreported), judgement of 13 July 2000. for the limitation to this principle to criminal liability.
[991] Opinion of Advocate-General Jacobs, case C-456/98, Centrosteel Srl, ECLI:EU:C:2000:137, para 35. See also Craig (2009), p. 349; Tridimas (2001), p. 327. See however the P. V. Figueroa Regueiro, Invocability of Substitution and Invocability of Exclusion: Bringing Legal Realism to the Current Developments of the Case-Law of 'Horizontal' Direct Effect of Directives, Jean Monnet Working Paper 7/02, p. 15, this principle should be extended also to non-criminal liability.
[991] See AG Saggio, in Joined Cases C-240/98 to C-244/98, *Océano Grupo Editorial SA*, para 28. The AG suggested that the principle of the primacy and the need to guarantee uniform application of the Community provisions imply that non-transposed directives may, once the period prescribed for their transposition into national law has expired, have the effect of *precluding application of the conflicting national rule*, even if the directive does not confer rights upon individuals.
[992] See C-282/10, Dominguez, ECLI:EU:C:2012:33, para 25. See for a comment: W. Van Gerven. '*Private Law in a Federal Perspective*', in R. Brownsword, H.-W. Micklitz, L. Niglia, S. Wheatherill (eds.), *The Foundations of European Private Law*, Oxford: Hart, 2011, p. 345.

[995] See Opinion of the Advocate General Jacobs in case C-456/98, *Centrosteel*, ECLI:EU:C:2000:137, para 35. For a critical view, see P. V. Figueroa Regueiro. 'Invocability of Substitution and Invocability of Exclusion: Bringing Legal Realism to the Current Developments of the Case-Law of 'Horizontal' Direct Effect of Directives', Jean Monnet Working Paper 7/02, p. 15.

[997] Joined Cases C-240/98 to C-244/98, *Océano Grupo Editorial SA*, ECLI:EU:C:2000:346, para 93.

judge should choose, among different interpretations, the one which better ensures the *effet utile* of EU law. The question of the limits of the conformity interpretation becomes more difficult for general private law remedies. This is because, unlike sectoral-statutory remedies, they are not aimed at compensating losses arising from the breach of regulatory duties but, more generally, from contractual duties. Indeed, the conferral of an implied remedy, based on the doctrine of conform interpretation, would be tantamount to granting horizontal direct effect to the MiFID. However, it could be argued that general private law can lead to the aggravation of private law duties imposed on financial firms.

This argument is supported by the recent judgment of the CJEU, concerning the interpretation of the Third Assurance Directive.[998] In this case, the CJEU was asked whether 'the "open and/or unwritten rules", i.e. the duty of care, pre-contractual good faith and requirements of reasonableness and fairness' could result in stricter information duties being imposed on the insurance firm vis-à-vis the client than those laid down in the national law transposing the directive. The CJEU answered in the affirmative but stated that the additional information required shall be clear, accurate and necessary for the policyholder to understand the essential characteristics of the commitment and that it ensures a sufficient level of legal certainty.[999] This means that with these two limitations, national private law duties can be stricter duties than regulatory requirements. In the examined continental jurisdictions, national courts have already applied this principle to financial litigation; namely, by imposing on firms stricter duties of conduct than those laid down by the pre-MiFID regulatory framework on the basis of the general duty of good faith. The UK courts, however, especially with regard to non-advised services, have followed a more conservative interpretative approach focused on the wording of contract terms and contract law than the purpose of regulatory duties. It is clear, therefore, that a the inherent limitation of the duty of conform/harmonious interpretation is that it may leave too room for national courts to design, *ex post,* the appropriate remedy to compensate clients, thus potentially undermining legal certainty and the uniform application of EU law (recital No 5 Commission MiFID I

[998] Case C‑51/13, *Nationale-Nederlanden Levensverzekering*, ECLI:EU:C:2015:286.
[999] Case C‑51/13, *Nationale-Nederlanden Levensverzekering*, para 34.

Directive), not only with regard to the executive conditions of the remedy (e.g. causation, quantification of damages) but also its constitutive conditions (i.e. where a remedy should exist at all).[1000]

2.3. The role of supervisory standards in the conform interpretation

As I have shown above, Union courts require national courts to interpret national law in light of the acts of 'soft law' (guidelines and recommendations[1001]) issued by EU institutions. Soft law, therefore, does not create only moral suasion but also legal obligations that can indirectly affect private law relationships.[1002] Yet, the question arises as to whether the breach of soft law, besides supervisory consequences, can also have horizontal effects.

Two recent judgments of the CJEU tackled the question of the horizontal effects of soft law, suggesting that whilst these measures cannot replace the contract terms set out by the parties (horizontal direct effects), they should drive the interpretation of EU law (horizontal indirect effects). In telecommunications law, the CJEU held that a national court hearing an appeal against an NRA decision imposing price control obligations on Dutch telecom operators has the right to challenge the proportionality of this measure with the EU legislation (Directive 2009/140/EC), even if the measure is based on a Recommendation 2009/396.[1003] The CJEU, however, did not expressly follow the view of Advocate General Mengozzi that this Recommendation should be taken into fully account and should enjoy a presumption of proportionality in relation to the objectives pursued by EU law.[1004] In another recent case the CJEU decided that a national standard

[1000] For the difference between constitutive and executive conditions see W. Van Gerven. 'Of Rights, Remedies and Procedures', 507.
[1001] See, in particular, Case 322/88 *Salvatore Grimaldi*, ECLI:EU:C:1989:646, para 22.
[1002] See K. J. Hopt. 'Contract Governance, Disclosure, and Rule-setting between the Market and the Law
A View from Commercial and Company Law' in S. Grundmann, F. Moslein, and K. Riesenhuber (eds.), Contract Governance. Dimensions in Law and Interdisciplinary Research, p. 467.
[1003] Case C-28/15, *Koninklijke KPN NV*, ECLI:EU:C:2016:692, para 52. The measure at stake was the OPTA (now ACM) Decision of 7 July 2010, OPTA/AM/2010/201951 which was annnulled by the Dutch Trade and Industry Appeals Tribunal (College van Beroepvoor het bedrijfsleven) with judgment of 31 August 2011.
[1004] Opinion of AG Mengozzi in Case C-28/15, *Koninklijke KPN NV*, ECLI:EU:C:2016:310, para 83.

transposing a European standard, approved by the European Committee for Standardization (CEN) cannot be relied upon by a party in order to claim compensation against another private party for breach of contract.[1005] However, the CJEU held that the fact that a measure of EU law has no binding effect does not preclude the Court from ruling on its interpretation in proceedings for a preliminary ruling under Article 267 TFEU.[1006] This means that even a non-legally binding standard can – and should – have an impact on the interpretation of the relevant national private law and therefore can have indirect effects on the property rights of market participants.

With regard to the ESAs acts, the argument that they should produce horizontal indirect effects can be supported by the fact that the mandate of the ESAs is to ensure the effectiveness of EU law and such a mandate can be carried out also through soft law acts. Since national courts have the duty to interpret national law in light of EU law, and the ESAs have the mandate to ensure that EU financial law is effectively applied, it follows that when different interpretations are availble, national courts should give preference to the one which is in line with the ESAs legal acts, even if non-legally binding on their addressee.

3. The protective scope of EU conduct of business rules

3.1. The individual rights of clients vis-à-vis financial firms: The problems at stake

When general private law concepts are at stake, the distinction between the interpretation of existing remedies and the creation of new remedies becomes blurred and essentially depends on the interpretative approach of national courts. Courts that favour a purposive interpretation of national law, will tend to extend the scope of the existing remedies as to adjust them to regulation; courts that adopt a literal interpretation of the law will reject the conform interpretation as a

[1005] Case C-613/14, *James Elliott Construction Limited v Irish Asphalt Limited*, ECLI:EU:C:2016:821.
[1006] Case C-613/14, *James Elliott Construction Limited v Irish Asphalt Limited*, para 35.

technique which would unlawfully create new remedies in the legal system overstepping the legislators.

The CJEU has indeed established, as a general principle, that in the absence of national and EU legislation new remedies can be imposed on private parties only in exceptional situations, the rule being that national law should be, as far as possible, interpreted in conformity with EU law.[1007] In fact, the flip-side of the principle of *ubi jus, ibi remedium* is that no remedy shall be imposed on a private party without a prior legislative conferral of a right on the other.[1008]

The key question is to understand when a EU law provision is right-conferring.[1009] Although the conferral of a right often derives from provisions that have direct effect (because individual rights are typically granted by virtue of clearly defined obligations imposed on other parties),[1010] there is no necessary coincidence between the conferral of a right and the direct effect.[1011] For this reason, to determine whether a provision is right-conferring it is not sufficient to see if it is sufficiently precise, unconditional and detailed but it is necessary to ascertain "whether the provision by its content and purport affords protection to the interests, which [the person] is invoking in law. There must be a link between the interest on which the person concerned is relying and the protection afforded by a provision of a regulation".[1012]

3.2. The *Peter Paul* case: the protective scope of prudential rules

The CJEU adopted the criterion of the purpose or protective scope of the EU law

[1007] See in particlar V. Tresnjack and E. Beysen. 'European Consumer Protection Law: Curia Semper Dabit Remedium?' 48 *Common Market Law Review* (2011): 105 and P. Rott. 'The Court of Justice's Principle of Effectiveness and its impact on Private Law Relationships' in D. Leczykiewicz and S. Weatherill (eds.).The Involvement of EU Law in Private Law Relationships, p. 190.
[1008] See in particular D. Leczykiewicz '*Private Party Liability in EU Law: In Search of the General Regime'* 12 Cambridge Yearbook of European Legal Studies (2009– 10): 257.
[1009] See in particular S. Prechal. *Directives in EC Law*, p. 99.
[1010] See, inter alia, Joined Cases C-6/90 and C-9/90, *Francovich,* ECLI:EU:C:1991:428, para 31.
[1011] See F. Wilman. *Private Enforcement of EU Law Before National Courts*, p. 29 and W. Van Gerven. 'Of Rights, Remedies and Procedures', 505: distinguishing between subjective direct effect (conferral of rights) and objective direct effect (direct effect of EU law).
[1012] See in particular the Opinion of AG Geelhoed in Case C-253/00, *Muñoz* ECLI:EU:C:2001:697, para 47 (in the judgment the court did not expressly refer to this criterion).

provision in state liability cases,[1013] including *Peter Paul*,[1014] which concerned the question whether a national legislation preventing individual from claiming damages for defective supervision, is in contrast with the Directives 77/780, 89/299 and 89/646 on banking activity. The CJEU decided that this national legislation is compatible with EU law because the fact that one of the objectives of these Directives is the protection of depositors does not mean that that Directives confer a legally enforceable right to the depositors.[1015] The most important argument in support of this ruling was that

> "rules [limiting liability of supervisory authorities] are based on considerations related to the complexity of banking supervision, in the context of which the authorities are under an obligation to protect a plurality of interests, including more specifically the stability of the financial system".[1016]

Later on, I will examine the problem of balancing competing public interests (protection of clients and financial stability). It is now important to say that this CJEU's reasoning, introduced much time before the Banking Union, could be justified nowadays because of the imperative need of protecting financial stability. Going forward, this judgment poses the question of the private enforceability of the micro-prudential requirements, now embedded in the CRR, a directly applicable act. Even if these rules are sufficiently clear, precise and unconditional (i.e. CRR's requirements for recognition of financial instrument as own funds, large exposures, internal rating models) it could be argued they are ill suited for private enforcement because their infringement is not observable by private parties and because of evidential problems, specifically the requirement to prove a quantifiable loss and the causal link between the infringement and the loss.[1017] However, some prudential rules could produce indirect horizontal effects. For example, Article 91 of the CRD IV, setting out requirements for the suitability of members of management bodies could by used by the shareholders in litigation against directors to set aside conflicting national laws and/or to drive the interpretation of

[1013] Joined Cases C-6/90 and C-9/90 Francovich, para 39. See in more detail N. Reich. 'Horizontal Liability in EC Law', 718.
[1014] Case C-222/02, Peter Paul, ECLI:EU:C:2004:606.
[1015] See C-222/02, *Peter Paul*, para 40.
[1016] Case C-222/02, *Peter Paul,* para 44.
[1017] See F. Wilman. *Private Enforcement of EU Law Before National Courts,* p. 490 and C. Hadjiemmanuil.'The Banking Union and Its Implications for Private Law: A Comment', p. 383.

national private law.

The *Peter Paul* judgment was criticised for several reasons. Some argued that the CJEU followed a very strict interpretation of the concept of 'right' (understood as enforceable entitlement, rather than a legal interest) and discarded the need to protect vulnerable parties against the misconduct of supervisors.[1018] Others noted that this strict interpretative approach was not consistently followed later on in the case law concerning the liability of private parties for the breach of EU law (including in *Courage*, *Munoz* and *Manfredi*)[1019]where the CJEU established that a private party can be liable for the breach of directly applicable EU law by focussing, rather than on the purpose and scope of the provision, on the need to ensure the effectiveness of EU law. [1020] The private enforcement was therefore regarded not as a consequence of the protective purpose of the norm, but as the precondition to ensure its effective application.[1021]

3.3. What is the the protective scope of the MiFID conduct of business rules?

Since *Peter Paul* concerned a case of state liability for the breach of prudential requirements, the CJEU's reasoning cannot be extended to horizontal liability cases concerning conduct regulation.[1022] Yet, the question arises whether, to determine if EU conduct regulation confers individual rights to clients, the strict *Peter Paul* approach or the effectiveness-driven approach should be followed.

[1018] See M. Tison. 'Do Not Attack the Watchdog! Banking Supervisor's Liability After Peter Paul' 42 Common Market Law Review (2005): 639-675.
[1019] See, in particular, Case C-453/99, Courage Ltd, ECLI:EU:C:2001:465; case C-253/00, *Muñoz* ECLI:EU:C:2002:497; case C-295/04, Manfredi, ECLI:EU:C:2006:461. Whereas in *Courage* and Manfredi the EU law provision already provided for some civil law consequences of its infringement (Article 101 TFEU) in *Munoz* the Regulations' provision at stake did not provide for any civil law consequence for their infringements. For a comment on these cases, see K. Havu. 'Horizontal Liability for Damages in EU Law—the Changing Relationship of EU and National Law' 18 European Law Journal (2012): 407–426.
[1020] See T. Eilmansberger. 'The Relationship between Rights and Remedies in EC Law: in search of the Missing Link' 1226.
[1021] See V. Tountopoulos. 'Market Abuse and Private Enforcement' 312.
[1022] See also F. Moslein. 'Third Parties in the European Banking Union', 552.

3.3.1 Genil v Bankinter

The CJEU dealt for the first time with this key issue in the landmark case *Genil v Bankinter*.[1023] As I mentioned above,[1024] the Spanish referring courts asked, among other questions, as to whether the omission of the MiFID I's appropriateness and suitability rules can determine the absolute nullity of the contract.[1025] The CJEU held that:

"although Article 51 of Directive 2004/39 provides for the imposition of administrative measures or sanctions against the parties responsible for non-compliance with the provisions adopted pursuant to that directive, it does not state either that the Member States must provide for contractual consequences in the event of contracts being concluded which do not comply with the obligations under national legal provisions transposing Article 19(4) and (5) of Directive 2004/39, or what those consequences might be. In the absence of EU legislation on the point, it is for the internal legal order of each Member State to determine the contractual consequences of non-compliance with those obligations, subject to observance of the principles of equivalence and effectiveness".[1026]

In this important passage, the CJEU implicitly considered that these MiFID rules are right-conferring (because, Member States should ensure equivalent and effective remedies only for the breach of rights conferred on individuals by EU law) but it did not clarify whether Member States have the duty – and not only the option – to provide for the contractual consequences of the breach of the MiFID conduct of business rules. The literal wording of the motivation could suggest that indeed Member States have only the option to determine such consequences and once they 'choose this option' they have to comply with the principles of equivalence and effectiveness. On the other hand, it could be argued that Member States have long time ago exercised this option by enacting their civil codes or developing their common law principles and therefore the duty to respect the principle of equivalence and effectiveness is already in force. This interpretation is further corroborated by the fact that the referring court asked the CJEU on the

[1023] Case C-604/11, *Genil v Bankinter*, ECLI:EU:C:2013:344.
[1024] See Chapter 6, above.
[1025] The CJEU rephrased this question in a slightly different way: 'what the contractual consequences are when an investment firm which offers an investment service fails to comply with the assessment requirements laid down in Article 19(4) and (5) of Directive 2004/39' (para 56).
[1026] Case C-604/11, *Genil v Bankinter*, para 57.

compatibility with EU law of a general contract law remedy (not a special statutory remedy), and therefore the CJEU answer should be read as referring to the contractual consequences 'based on general contract law'. This conclusion, however, needs to be assessed in light of two recent judgments where the CJEU and held a more restrictive view of the MiFID I scope of protection.

3.3.2 Banif Plus Bank Zrt. v Márton Lantos

In this case, the issue at stake was the interpretation of a foreign currency denominated consumer credit agreement concluded by a consumer in order to purchase a motor vehicle.[1027] The referring court asked in particular whether this contract fell within in the MiFID's notions of investment services or activities and, if so, whether the breach of the MiFID suitability and appropriateness rules determine the annulment of this contract. The CJEU, following the Advocate General, decided that this contract does not qualify as an investment service and therefore established that the MiFID conduct rules were not applicable to this transaction. In particular, according to the CJEU:

> "transactions such as this serve no other function than to be the manner of performing the fundamental payment obligations under the loan agreement, consisting in the lender's making the capital available and the borrower's repayment of the capital together with interest. Those transactions do not have as their purpose the completion of an investment, as the consumer is seeking only to secure funds with a view to purchasing a consumer good or a service, not, for example, to manage a foreign exchange risk or speculate on a currency's exchange rate".[1028]

Even if the CJEU decided that the MiFID conduct rules could not be applied to the contract, it reiterated, 'in so far as relevant' the principle already established in *Genil v Bankinter* in para 57, above.[1029]

[1027] Case C-312/14, *Banif Plus Bank Zrt. v Márton Lantos*, ECLI:EU:C:2015:794.

[1028] Case C-312/14, *Banif Plus Bank Zrt. v Márton Lantos*, para 57.
[1029] Case C-312/14, *Banif Plus Bank Zrt. v Márton Lantos*, para 79.

3.3.3 Mohammad Zadeh Khorassani v Kathrin Pflanz

In another recent case, the German Supreme Court asked the CJEU whether the MiFID's service of the 'reception and transmission of orders in relation to one or more financial instruments' also covers the conduct of a natural person (not authorized as an investment firm) who has brokered to the client the conclusion of a portfolio management agreement with a Liechtenstein-based investment firm.[1030] In the main proceeding, whilst the lower courts dismissed the claim for compensation brought by the client against the natural person, under the Section 823(2) of the BGB, the German Supreme Court had doubts whether the brokering of a portfolio management includes also the circumstance when a specific financial instrument is purchased or should also be extended to services when there is only a brokering of the portfolio management, as the plaintiff maintained.

The German, UK and Portuguese governments claimed that the 'reception and transmission of orders' should be interpreted as including also this atypical service to ensure a high level of client protection. By contrast, the Commission and the Polish government supported the narrower interpretation; namely, that the service of 'reception and transmission of orders' presupposes that there is an order and this cannot be dissociated from the specific financial instruments in relation to which a purchase, transfer or other similar transaction is 'ordered'.

In following this restrictive interpretation, the Advocate General Campos Sánchez-Bordona underlined two important aspects. First, that "the application of the rules for protection of investors may not lead to disproportionate results, like the extension of the controls provided for in the MiFID I to any operator and to all types of financial service".[1031] Second, that "the protection of users of financial services, as the 'weaker' party in the relationship, does not make it lawful to dispense with the requirements inherent in the correct interpretation of legal provisions, especially if the latter leaves open other methods of safeguarding the rights and

[1030] Case C-678/15, Mohammad Zadeh Khorassani contro Kathrin Pflanz ECLI:EU:C:2017:451.
[1031] Opinion of the Advocate General Campos Sánchez-Bordona in case C‑678/15, Mohammad Zadeh Khorassani v Kathrin Pflanz, ECLI:EU:C:2017:100, para 58.

interests of investors", namely to sue the investment firms based in Lichtenstein.[1032]

In line with the Advocate General, the CJEU adopted the restrictive interpretation and specified that investor protection objective, which is only one of the MiFID objectives, cannot justify a broad interpretation of the notions of investment services and activities.[1033] Much like the *Bankif Plus Bank* judgment, this judgment would confirm that the investor protection objective, whilst remaining the primary objective of the MiFID, is not absolute and cannot be used to extend the protective scope of the MiFID as to include 'atypical' or un-regulated, services which, nevertheless, can play an economic function akin to that of regulated services.

4. The functions of the principle of effectiveness in EU financial regulation

4.1. The 'eliminatory function'

An important aspect of the *Bankinter v Genil* and *Bankif Plus Bank* judgments is that they reiterated that, irrespective of the interpretation of the concept of investment service and activity, the MiFID I conduct of business rules of Article 19 (now Article 24 of the MiFID II) are right-conferring andtherefore the contractual consequences for their infringement should met the principles of equivalence and effectiveness. Unlike the principle of equivalence, which transposes the general principle of non-discrimination to national private remedies and procedures,[1034] the principle of effectiveness has prompted increasing scholarly attention particularly because the CJEU has recently used this principle to shape and also introduce new private law remedies into national legal orders.[1035]

[1032] Opinion of the Advocate General Campos Sánchez-Bordona in case C‑678/15, Mohammad Zadeh Khorassani v Kathrin Pflanz, para 61.
[1033] Case C-678/15, Mohammad Zadeh Khorassani v Kathrin Pflanz,ECLI:EU:C:2017:451, para 42.
[1034] In more detail, on the priciple of equivalence see M. Bobek. 'Why There is No Principle of 'Procedural Autonomy' of the Member States', in H.-W. Micklitz and B. De Witte (eds). *The European Court of Justice and the Autonomy of the Member States,* p. 312
[1035] See, for the development of the principle of effectiveness in the case law, M. Dougan. 'The vicissitudes of life at the coalface: Remedies and procedures for enforcing Union law', in P. Craig and G. de Burca (Eds.). *The Evolution of EU Law,* p. 424.

An important distinction should be made between the eliminary function of the principle of effectiveness, as defined by the CJEU in the landmark *Rewe-Zentralfinanz and Rewe-Zentral*, and its new upgrading function, which emerged in particular from recent CJEU's case law in consumer law matters.

The traditional function of the principle of effectiveness is to eliminate the restrictions to the protection of the EU-derived individual rights and not to introduce new remedies into the national legal orders.[1036] This is so because, being a corollary of the principle of sincere cooperation (Article 4 of the TEU), the principle of effectiveness presupposes that Member States enjoy discretion in how to ensure the protection of the EU-derived rights. To ensure whether this discretion is legitimate, the CJEU should take into account "the role of that provision in the procedure, its progress and its special features, viewed as a whole, before the various national instances (contextual criterion) and the basic principles of the domestic judicial system, such as protection of the rights of defence, the principle of legal certainty and proper conduct of procedure"' (balancing criterion).[1037]

In addition, the traditional principle of effectiveness requires also a clear division of tasks between the CJEU, on the one hand, and the national courts on the other: the CJEU should limit its scrutiny to the interpretation of EU law, following the contextual and balancing criteria, national courts shall apply EU law, as interepreted by the CJEU to the case and resolve the dispute.[1038] In this regard, in *Bankinter* and *Bankif Bank* the CJEU adhered to the orthodox application of the principle of effectiveness because it did not assess whether the remedy was capable of protecting the rights of the clients. By contrast, in *Mohammad Zadeh Khorassani v Kathrin Pflanz* the Advocate General adopted a less traditional approach because, although not referring to the principle of effectiveness, he concluded that the

[1036] See Case C-432/05 *Unibet*, EU:C:2007:163, para 40. See in particular N. Reich. *General Principles of EU Civil Law*, 92 and P. Rott. 'The Court of Justice's Principle of effectiveness and its Unforesseable Impact on Private Law Relationships' , 182

[1037] Joined Cases C-430-431/93, *Van Schijndel*, EU:C:1995:441, para 19 and Case C-312/93, *Peterbroeck*, EU:C:1995:437, para 14.

[1038] See in particular P. Rott. 'The Court of Justice's Principle of effectiveness and its Unforesseable Impact on Private Law Relationships', 192. For the distinction between interpretation and application of EU law, see the opinion of the Advocate General Ruiz-Jarabo Colomer in case C-30/02 *Recheio – Cash & Carry SA*, ECLI:EU:C:2003:666, para 35.

protection of investors is 'sufficiently guaranteed' by the MiFID I as the client can bring the claim against the portfolio management companies in Liechtenstein.

Regrettably, however, the Advocate General did not assess whether this option, certainly feasible for the client in theory, could be excessively difficult in practice due to the difficulties (economic, knowledge, competence) that he or she might encounter in bringing a lawsuit outside his or her own jurisdiction. In addition, even if under the principle of effectiveness, Member States could provide for other legal remedies to ensure the effectiveness of the MiFID (i.e. administrative enforcement and ADRs), it must be recalled that the principle of effectiveness does not require obliged parties to "to have recourse systematically to all the legal remedies available to them even if that would give rise to excessive difficulties or could not reasonably be required of them".[1039]

It remains to be seen how the CJEU will assess the principle of effectiveness regarding the MiFID II. Indeed, Article 69 (and indirectly Article 75) of the MiFID II does lay down the essential constitutive conditions for a liability remedy and therefore – it is submitted – Member States have the duty to introduce private liability remedies or equivalent remedial forms, remaining free to lay down the executive conditions of the remedy, subject to the principle of effectiveness and equivalence.[1040]

4.2. The 'upgrading function'

The upgrading function of effectiveness is to strengthen – and hence 'upgrade' – national private law remedies and procedures in order to ensure a standard of effective judicial protection, thus determining – in the words of Norbert Reich – the hybridization of national private law.[1041] This hybridization effect can derive from

[1039] Case C-445/06, *Danske Slagterier*, ECLI:EU:C:2009:178, para 62. See also, with regard to consumer law, H. Micklitz and N. Reich. 'The Court and Sleeping Beauty: The revival of the Unfair Contract Terms Directive (UCTD)' 51 Common Market Law Review (2014): 804.
[1040] See also D. Busch. 'The Private Law Effect of MiFID I and MiFID II' in D. Busch and G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, p. 570.
[1041] See N. Reich. 'Horizontal Liability in EC Law', 713; N. Reich. General Principles of EU Civil Law, p.

an *ad hoc* application of the traditional effectiveness, taking into account the specific factual and legal context of the case,[1042] and from the interpretation of national law in light of the principle of 'effective legal protection' laid down in Article 19 TEU and the fundamental 'right to an effective remedy' of Article 47 of the CFR.[1043]

Article 19 TUE, unlike the principle of effectiveness, prescribes that the remedy must not only be equivalent and effective but also sufficient or adequate to protect the EU-derived individual rights.[1044] In this way, the adequate remedy as a pre-condition of the legal (not only judicial) protection of rights, thus underlying the importance of the private enforcement of EU law in the post-Lisbon institutional framework.[1045] The adequacy standard should be identified taking into account the nature and importance of the interest restricting the protection of the client,[1046]as well as the interest which would be sacrificed, should national procedural law prevail.

The upgrading/hybridization effect can also take place through the horizontal application of Article 47 of the CFR. This provision, differently from Article 19 TUE which addresses only Member states, grants directly to the individual the fundamental right to an effective remedy; this right can be invoked against Member States, the EU and private parties.[1047] Therefore, unlike the principle of full effectiveness and the Rewe-effectiveness, which aim to ensure the Member States'

708 and C. Mak. 'Rights and Remedies: Article 47 EUCFR and Effective Judicial Protection in European Private Law Matters, in H.-W. Micklitz (ed.). Constitutionalization of European Private Law, Oxford: Oxford University Press, 2014, p. 253.

[1042] See F. Della Negra. 'The uncertain development of the case law on consumer protection in mortgage enforcement proceedings: Sánchez Morcillo and Kušionová' 52 Common Market Law Review (2015): 1020.

[1043] See N. Reich. General Principles of EU Civil Law, p. 708.

[1044] See Authors mentioned in the previous footnote and, before the Lisbon Treaty, W. Van Gerven. 'Of Rights, Remedies and Procedures', 503.

[1045] See N. Reich. *General Principles of EU Civil Law* p. 98 and H.-W. Micklitz. 'The ECJ Between the Individual Citizen and the Member States', p. 373.

[1046] Advocate General Wahl, Case C-482/12, Peter Macinský, ECLI:EU:C:2013:76, para 76.

[1047] See, on the differences between effectiveness and effective judicial protection, R. Widdershoven and S. Prechal. 'Redefining the Relationship between 'Rewe-effectiveness' and Effective Judicial Protection' 2 Review of European Administrative Law (2011): 38.

compliance with the obligations imposed by EU law,[1048] this fundamental right aims to ensure that the individuals can effectively protect their rights. In practice, this upgrading function should lead national courts and adjudicators to consider whether the national private law remedies are adequate to protect the rights-conferred on investors by the MiFID. Hence, contrary to the traditional effectiveness, the upgrading effectiveness could support the introduction of new remedies or the broadening of the constitutive or executive conditions for the exercise of the remedy.[1049]

4.3. The complex relationship between effective judicial protection and effectiveness of EU law

The upgrading function of the principle of effectiveness shows, however, the uneasy interplay between the protection of individual and the effective application of EU law. Generally speaking, the protection of individual and the effectiveness of EU law are mutually reinforcing principles: the enforcement of EU law ensures the effective protection of the individual and vice versa. However, when the protection of the individual is not the only objective pursued by the EU law provision, the effective application of EU law may not automatically increase the effective protection of the individual.[1050] In practice, this could happen when:

(i) the private enforcement of EU law does not give compensation to the individual (e.g. because the private enforcement action is taken by the Commission, on behalf of the EU, before national courts);[1051]
(ii) compensation is not the result of the effective enforcement of EU law (e.g. because the dispute is not resolved based on legal rules and principles, as in the case of out-of-court dispute resolution); or
(iii) the effective enforcement of EU law reduces the private law rights that the

[1048] See P. Nebbia. 'The Double Life of Effectiveness', 10 Cambridge Yearbook of European Legal Studies 2007/2008: 288.
[1049] See also H. Micklitz and N. Reich. 'The Court and Sleeping Beauty: The revival of the Unfair Contract Terms Directive (UCTD)', 807.
[1050] See F. Wilman. *Private Enforcement of EU Law Before National Courts*, p. 463.
[1051] Case C-199/11, Europese Gemeenschap v Otis NV, ECLI:EU:C:2012:684.

client would have enjoyed under national law (e.g. in the cases of the PRIIPs, CRA and EMIR Regulations or the application of the resolution tools of the BRRD which restrict the property rights of investors)[1052].

In these three scenarios, it is particularly important to clarify the relationship between the principle of effectiveness and effective judicial protection. In some judgments the CJEU assessed national private law only against the effectiveness/equivalence requirements;[1053] in others – particularly in consumer law matters – the CJEU assessed private law remedies against the double standard of Rewe-effectiveness and effective judicial protection (i.e. by integrating the effective judicial protection standard into the Rewe-effectiveness one).[1054] It is submitted that the latter approach better reflects the constitutional importance of Article 47 of the CFR which shall "apply to, and must be respected at, all levels of EU law adjudication, irrespective of the degree of autonomy left to the Member States".[1055] This means that, whilst a ponderation is necessary when there is a conflict between effective application of EU law and principle of effective judicial protection,[1056] prevalence should be given to the need of ensuring the individual rights conferred on the individuals by EU law.

5. The impact of the principle of effectiveness on national private law remedies

What is the concrete impact of the upgrading effectiveness on national private law remedies? To answer this question, attention should be paid to the restitutionary and compensatory remedies, which have been widely used by national courts to grant redress to clients in mis-selling cases.

[1052] See Chapter 3, above.
[1053] Case C-12/08, *Mono Car Styling*, EU:C:2009:466, para 49; JoinedCasesC-317-320/08,*RosalbaAlassini*,EU:C:2010:146, para 61; Case C-93/12 Agrokonsulting, ECLI:EU:C:2013:432.
[1054] Case C-432/05 *Unibet*, EU:C:2007:163, para 37; Case C-268/06, *Impact,* EU:C:2008:223, para 47; Case C-63/08, *Pontin*, EU:C:2009:666, para 44; case C-169/14, *Sánchez Morcillo*, para 35. See also, with regard to the private enforcement of EU competition law, the Opinion of the AG Jaaskinen, case C‑536/11, *Bundeswettbewerbsbehörde v Donau Chemie AG*, ECLI:EU:C:2013:67, para 47.
[1055] M. Safjan and D. Dusterhaus. 'A Union of Effective Judicial Protection: Addressing a Multi-level Challenge through the Lens of Article 47 CFREU' Yearbook of European Law (2014): 24.
[1056] See C. Mak. 'Rights and Remedies: Article 47 EUCFR and Effective Judicial Protection in European Private Law Matters', p. 253.

5.1. Restitutionary remedies

5.1.1. The balance between the consumer and the firm's interests

Restitutionary remedies (absolute or relative nullity) aim to place the investor in the position he or she was in before the conclusion of the contract. Whilst this restitutionary effect enhances deterrence, it may undermine the safety and soundness of financial firms as well as the stability of the financial system. In fact, since the avoidance of a standard contract term can extend its effects to all the same clauses of other standard terms[1057] and to interconnected contracts, it could trigger a cascade of consequential restitutionary claims against the injured party with the risk of amplifying the systemic harm. For this reason, some national laws have introduced statutory limits to the availability of this remedy in relation to the breach of certain regulatory duties (i.e. authorization requirements).[1058]

Whereas in *Genil GL v Bankinter* and *Banif Plus Bank* the CJEU did not decide whether the restitutionary remedy at stake in the main proceeding was compatible or sufficient to ensure the effectiveness of the MiFID, in other judgments the CJEU gave some guidance as to the compatibility of the restitutionary and retroactive effects of the avoidance with EU law.[1059] In particular, in *Friz* the CJEU was asked whether, under the Directive 85/577/EEC, the right of withdrawal of a consumer a membership with a real estate fund, entered after a doorstep transaction, can produce retroactive effects (*ex tunc* effects), in the sense that the consumer should be released from any obligation arising from his or her participation to the fund.[1060] The CJEU, following the opinion of Advocate-General Tresnjack, decided that the

[1057] See, case C-472/10, Invitel, ECLI:EU:C:2012:242.
[1058] See Section 20 of the FSMA and in the Netherlands Section 1:23 of DFSA.
[1059] See Case C-106/89, *Marleasing,* ECLI:EU:C:1990:395 where the CJEU decided that Article 11 of Council Directive 68/151/EEC precludes a declaration of nullity of a public limited company on a ground other than those listed in Article because the purpose of the directive (not implemented) was to limit the cases in which the nullity of the company may arise to ensure 'certainty in the law as regards relations between the company and third parties'.
[1060] Case C-215/08, *E. Friz GmbH*, ECLI:EU:C:2010:186. In the main proceeding the fund claimed from the consumer the sum of EUR 16 319, corresponding to the difference between the value of the initial investment paid by that latter at the date he entered that partnership and his share of the losses which had been incurred by that partnership at the date that membership was cancelled.

Directive did not preclude the termination of the contract being ordered to have *ex nunc* effects.

To support this claim the CJEU held that, in accordance with the general principles of civil law, a satisfactory balance and a fair division of the risks among the various interested parties, namely by offering the consumer the possibility to cancel his or her membership of the a closed-end real property fund and to recover his or her holding, while taking on a proportion of the risks inherent to any capital investment of the type at issue in the main proceedings.[1061] This point was made even clearer by Advocate General Tresnjack who pointed out that this Directive "seeks to protect consumers from the hasty conclusion of a contract away from business premises, not from the risks inherent in capital investments".[1062]

The question arises as to whether this balancing between consumer and firm's interest can be made also regarding EU financial regulatory duties. The CJEU gave a convincing answer in *Hirmann v Immofinanz AG* where a distinction was made between the case where the restitutionary effects depend from an autonomous choice of the consumer (as in *Friz*) and when they are the result of the firm's unlawful conduct. In such a case the CJEU, specified that "there is no justification for having recourse to the test of a satisfactory balance and a fair division of the risks among the various interested parties, as referred to in *E. Friz*, as an aid to the assessment of the compatibility of a rule of national law with European Union law".[1063]

5.1.2. The balance between client protection and financial stability

However, after the global financial crisis, another important balance to be striken is between the (private) interests of the contracting parties and the (public) interest of third-parties which could be harmed by the negative externalities of the

[1061] Case C-215/08, *E. Friz GmbH*, para 48. See for a comment N. Reich. *General Principles of EU Civil Law*, p. 141.
[1062] Opinion of the Advocate General Trstenjak, in case Case C-215/08, *E. Friz GmbH*, ECLI:EU:C:2009:522, para 31.
[1063] Case C-174/12, *Hirmann v Immofinanz AG*, ECLI:EU:C:2013:856, para 62.

restitutions.

In the recent *Francisco Gutiérrez Naranjo* case, the CJEU for the first time considered the issue of whether restitutions should be limited to ensure the stability of the financial system.[1064] In 2013[1065] and 2015[1066] the Spanish Supreme Court held that the 'floor' clauses in consumer mortgage loan contracts are unfair and therefore shall be null and void. However, the Supreme Court limited the temporal effects of its judgments in particular because there was a risk that restitutions would trigger systemic risks.[1067] Against this background, three Spanish Courts asked to the CJEU whether Article 6(1) of Directive 93/13 (also 'UCTD') precludes a national case-law that temporally limits the restitutory effects of the judicial declaration of unfairness.

In his opinion, the Advocate General Mengozzi gave a negative answer for the following main arguments. First, the UCTD does not prescribe that unfair terms shall be void but only that they shall be non-binding on the consumer; hence, it is for national law to determine the contractual consequences of the unfairness, including possible restitutionary effects.[1068] Second, the principle of effectiveness is respected because the 'floor' clauses are deemed to be void *pro futuro* and because, even in the absence of retroactive effects of the nullity, the consumer could repay the loan with another from a different banking institution.[1069] Third, and more importantly, a balance must be struck between the protection of consumers and the "macroeconomic challenges to the already weakened banking system of a Member State", provided that this approach remains exceptional.[1070] Hence, "the legal security advanced by that court — less on account of the innovative nature of its decision, I would recall, than on account of the many legal situations which are

[1064] Joined cases C-154/15 and C-307/15, *Francisco Gutiérrez Naranjo*, ECLI:EU:C:2016:980.
[1065] Judgment No 241/12 (ES:TS:2013:1916).
[1066] Respectively, judgment No 139/2015 (ES:TS:2015:1280) and judgment No 222/2015 (ES:TS:2015:2207).
[1067] Concerning those two criteria, the Tribunal Supremo (Supreme Court) referred to the judgment of 21 March 2013 in *RWE Vertrieb* (C-92/11, EU:C:2013:180).
[1068] Opinion of the Advocate General Mengozzi Joined cases C-154/15 and C-307/15, Francisco Gutiérrez Naranjo v Cajasur Banco SAU ECLI:EU:C:2016:552, para 63.
[1069] Opinion of the Advocate General Mengozzi Joined cases C-154/15 and C-307/15, Francisco Gutiérrez Naranjo, para 72.
[1070] Opinion of the Advocate General Mengozzi Joined cases C-154/15 and C-307/15, Francisco Gutiérrez Naranjo, para 72.

potentially affected and which could undermine the *stability of an economic sector* — is a concern shared by the EU legal order".[1071] It is noteworthy that the Advocate General Mengozzi spoken about economic stability which is notably broader than financial stability and therefore capable of affecting the Spanish economy as a whole.

The CJEU, however, did not follow his opinion and decided that the Directive 1993/13 precludes a national case-law that temporally limits the restitutory effects connected with a finding of unfairness by a court. After having recalled, in line with the settled case law, that the Directive aims to restore the effective equality of the consumer vis-à-vis the business, the CJEU considered the rationale for the restitutionary effect of the avoidance of unfair terms. In this regard, the CJEU pointed out that even if the Directive does not expressly regulate the civil law effects of the unfairness – a point emphasised by the Advocate General – "the determination by a court that such a term is unfair *must*, in principle, have the consequence of restoring the consumer to the legal and factual situation that he would have been in if that term had not existed".[1072] This is because "the absence of such restitutory effect would be liable to call into question the dissuasive effect'' of the Directive 93/13.[1073]
Remarkably, the CJEU never referred in its reasoning to the need to balance the protection of consumers with financial or economic stability. This could be seen as the evidence that when the firm's breaches the EU-derived standards of conduct, there should be no balancing between the parties and third party interests, but the parties' interests should prevail.

5.2. Compensatory remedies

From a financial stability perspective, compensatory remedies are less problematic than restitutionary remedies because the amount of compensation to be paid to the investor is generally lower, than that of restitution and because liability remedies

[1071] Opinion of the Advocate General Mengozzi Joined cases C-154/15 and C-307/15, *Francisco Gutiérrez Naranjo*, para 74.
[1072] Joined cases C-154/15 and C-307/15, *Francisco Gutiérrez Naranjo*, para 61.
[1073] Joined cases C-154/15 and C-307/15, *Francisco Gutiérrez Naranjo*, para 63.

do not trigger restitutionary effects from third parties. However, also civil liability can have repercussions on financial stability, particularly if the defendant is a supervisory authority or a systematically important firm.

The CJEU has not yet considered whether and how the compensation should be tailored to meet the standards of the ISD and the MiFID I. The reason could be that these Directives do not lay down the constitutive conditions for the remedy and therefore Member States cannot be required to establish a specific statutory remedy to ensure the MiFID's effectiveness. In practice, however, since general private law generally affords liability remedies, in contract and tort, the relevant question is how these remedies should be designed to comply with the principle of effectiveness. In this regard, particular attention should be paid to the causation and the quantification of damages.

5.2.1 Causation

A necessary requirement for successful liability (contractual, pre-contractual and tortious) claim is that a causal link exist between the firm's breach and the loss suffered by the client.[1074] As I shown above, national courts have adopted different models of causation, oscillating from a more traditional 'but for test' or *conditio sine qua non* and more innovative 'loss of chance' theories or contributory theories of causation.[1075]

Under general EU law causation is a requirement to establish the liability of EU institutions, Member States, as well as private parties individuals for the breach of EU law.[1076] In the recent *Kone* case, the CJEU introduced a new causation test with regard to the losses suffered by the client as a result of the losses resulting from umbrella pricing caused by a cartel.[1077] The CJEU held that the full effectiveness of

[1074] I refer here to the natural causation or causation in fact; for the difference between natural and legal causation, see the Principles of European Tort Law (PETL): art. 3:101 and 3:201).
[1075] See Chapter 6, above.
[1076] See, in particular, N. Reich. 'Horizontal Liability in EC Law', 726. In horizontal liability cases, see Joined Cases C-295/04 to C-298/04, Manfredi, para 17.
[1077] Case C-557/12, *Kone AG and Others*, ECLI:EU:C:2014:1317. In the national proceeding, the injured party claimed damages by alleging that the price paid for the purchase of an elevator from a manufacturer not involved in the cartel, was nevertheless set under the protection of the elevator

this Treaty's provision would be undermined by a national law which makes the claim for compensation subject to the existence of a 'direct causal link' between the breach and the loss and excludes compensation when the loss is the result of the cartel that contributed to the distortion of price formation mechanisms governing competitive markets.[1078]

The question arises as to whether this causation test, based on the mere contribution rather than the traditional counterfactual 'but-for test', can be extended to the breach of MiFID-derived conduct of business rules, particularly in the case of indirect or remote damages caused by the failure of the issuer. In her opinion in *Kone*, Advocate General Kokott incidentally held that the prices of financial instruments traded on secondary markets rarely have only one cause and can be determined by many factors beyond the control of the contractual parties, such as an capital issuance launched by a firm's competitor, the corporate restructuring of the issuer or any supervisory/enforcement action, or the other concurrent to other advice but from other non-qualified advices or prevailing opinions in the market.[1079] Therefore, as the Dutch Supreme Court held in the *World Online* judgment, an issuer's liability case, the traditional but-for test should not apply in particular circumstances, such as if professional investors are involved, because, given their knowledge and experience, they are not actually misled by the incorrect information.[1080]

Since the MiFID I does not lay down the constitutive conditions for the civil liability of the firm, it would be more difficult than in competition law, where causation ever since *Manfredi* has been one of the constitutive conditions of the remedy, to 'anchor' the contributive causation to a specific EU law requirement. However, the discourse is different for the MiFID II. Remarkably, its Article 69 specifies that

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cartel and was thus higher than would otherwise have been expected under competitive conditions. Austrian courts dismissed the claim because of the lack of causation between the cartel and the loss suffered by the customer. See for a comment J. Stuyck. 'Damages for the Loss Caused by a Cartel: The Causal Link Comments on the *Kone* Judgment of the Court of Justice of the EU' 3 European Review of Private Law (2015): 459–470.

[1078] Case C-557/12, *Kone AG*, para 33.

[1079] Opinion of the Advocate General Kokott in case C-557/12, *Kone AG*, ECLI:EU:C:2014:45, para 39.

[1080] Hoge Raad 27 november 2009, JOR 2010/43 (VEB e.a./World Online e.a.) with the comment of B. J. De Jong. 'Liability for Misrepresentation – European Lessons on Causation from the Netherlands' 8 European Company and Financial review (2011): 364.

compensation should be granted for "any financial loss or damage suffered *as a result* of an infringement" of the Directive or the MiFIR. Whilst the wording could suggest that the causal link must be direct, the compensatory purpose of the provision, read in light of the (remedial function) of the principle of effectiveness suggests that the causal connection should be established also when the infringement is only one of the contributing factors causing the loss.[1081]

5.2.2 Quantification of damages

The quantification of damages for losses caused by the breach of financial regulatory duties is a vexed issue not only for the difficulties to estimate the what would be the value that the financial instrument in the absence of the breach of duty but also because of the need to balance a compensation and deterrence. The CJEU addressed these issues in the recent case *Hirmann v Immofinanz AG,* mentioned above. In this case, the CJEU was asked whether national legislation that, as result of infringement of prospectus rules imposes on the issuerthe duty to repay to the purchaser a sum equivalent to the purchase price of the shares and to redeem those shares, is compatible with the prospectus, transparency and market abuse directives. The CJEU observed that:

"while it is true that, unlike Article 25(1) of the prospectus directive, Article 28(1) of the transparency directive and Article 14(1) of the market abuse directive do not expressly refer to the civil liability regimes in the Member States, the fact remains that the Court has previously ruled that, in respect of the award of damages and the possibility of an award of punitive damages, in the absence of European Union rules governing the matter, it is for the domestic legal system of each Member State to set the criteria for determining the extent of the damages, provided that the principles of equivalence and effectiveness are observed".[1082]

Then, the CJEU went on to say that:

"the civil liability regime provided for in the national legislation at issue in the main proceedings constitutes an appropriate remedy for the harm suffered by the investor and for the failure of the

[1081] See D. Busch. 'The Private Law Effect of MiFID I and MiFID II' in D. Busch and G. Ferrarini (eds.). *Regulation of the EU Financial Markets*, p. 582.
[1082] Case C-174/12, *Alfred Hirmann v Immofinanz AG*, para 40.

issuing company to comply with the information requirements. Further, it is capable of deterring issuers from misleading investors".[1083]

Therefore, differently from *Bankinter and Banif*, which can be regarded as 'deference cases', because the CJEU did not assess the compatibility of national law with the principle of effectiveness, this case can be regarded as an 'outcome case' because the Court assessed whether national law is effective, giving a clear-cut solution to the national court.[1084]

This different approach can be mainly explained because, unlike the MiFID I, the Prospectus and Transparency require Member States (Article 6 and 7, Prospectus and Transparency Directives), to provide for the civil liability of the issuer of securities and therefore lay down the minimum EU constitutive condition of the liability remedy.[1085] In addition, and more importantly, the CJEU in *Himmofinanz* acknowledged, *expressis verbis*, that civil liability in securities law can have also a deterrent function. This could provide a basis to argue that the amount of damages for the firm's breach of conduct regulation should include both the actual loss (*damnum emergens*) and the loss of profit (*lucrum cessans*), plus interest.[1086] Article 69 of the MiFID II further confirms this thesis because it expressly requires that compensation should be given for 'any loss', thus including the loss of profit.

Finally, a critical issue that has arisen in some jurisdictions is the extent to which national private law can impose to the retail client a duty to prevent or mitigate the loss caused by the financial firm. The CJEU held that it is a general principle common to the legal systems of the Member States that the injured party must show reasonable diligence in limiting the extent of the loss or damage, or risk having to bear the loss or damage himself.[1087] In light of this principle, which can also be read in light of the principle of consumer's self-responsibility, affirmed in

[1083] Case C-174/12, *Alfred Hirmann v Immofinanz AG*, para 42.
[1084] See, for the distinction within preliminary rulings between outcome, guidance and deference cases, T. Tridimas. 'The ECJ and national courts: dialogue, cooperation and instability', in D. Chalmers, A. Arnull (eds.). *The Oxford Handbook of European Union Law*, Oxford: Oxford University Press, 2015, p. 409.
[1085] In fact, in *Himmofinanz*, the CJEU resorted to *Rewe-Zentralfinanz and Rewe-Zentral*-effectiveness only to 'govern' the executive conditions of the liability remedy.
[1086] See in general EU law N. Reich. 'Horizontal Liability in EC Law', 730.
[1087] C-445/06, *Danske Slagterier*, para 60.

particular in *Asturcom* and *Messner,*[1088] EU law does not preclude national law from requiring investors to take the necessary measures to prevent the damage to occur (e.g. divestment of securities).

6. The role of EU fundamental rights in financial disputes

6.1. The problems at stake

Whilst the MiFID I was silent on fundamental rights, the MiFID II declares that the Directive respects the right to the protection of personal data, the freedom to conduct a business, the right to consumer protection, the right to an effective remedy and to a fair trial, the right not to be tried or punished twice for the same offence and has to be implemented in accordance with those rights and principles (recital No 166).[1089] Even if the practical impact of these statements remains unclear,[1090] they certainly reflect the increasing importance of fundamental rights in EU legislation and case law. It is not possible in this study to investigate the complex and intricated issues concerning the constitutionalization of private law.[1091]

Our more limited ambition is to shed some light on how the EU fundamental rights can influence the private law relationships between financial firms and clients and what could be the impact of the horizontal application of fundamental rights on the outcome of the dispute. As is well known, in a civil proceeding both of the parties can legitimately claim that their fundamental rights are at stake.[1092] In particular, the client can invoke his or her fundamental right to an effective remedy (Article 47(1) of the CFR) and the principle of consumer protection (Article 38 of the CFR),

[1088] Case C-40/08, *Asturcom*, ECLI:EU:C:2009:615 and case C-489/07, *Messner*, ECLI:EU:C:2009:502.
[1089] See also recital No 39 of the PRIIPs Regulation.
[1090] See O. O. Cherednychenko. 'Fundamental Rights, European Private Law and Financial Services', in H.-W. Micklitz (ed.). *Constitutionalization of European Private Law*, p. 176.
[1091] See, in particular, G Brüggemeier, G Comandè and A Colombi Ciacchi (eds), *Fundamental Rights and Private Law in the European Union* (Cambridge University Press, 2010); M. Safjan. 'The horizontal effect of fundamental rights in private law – on actors, vectors, and factors of influence', in K Purnhagen and P Rott (eds), *Varieties of European Economic Law and Regulation: Liber amicorum for Hans Micklitz* (Springer, 2015) 123. O.O. Cherednychenko and N. Reich. 'The Constitutionalization of European Private Law: Gateways, Constraints, and Challenges' (2015) 23 *European Review of Private Law* 799.
[1092] See in particular H. Collins. 'On the Incompatibility of Human Rights Discourse and Private Law', in H.-W. Micklitz (ed.). *Constitutionalization of European Private Law*, p. 49.

the financial firm can invoke its freedom to conduct a business (Article 16 of the CFR) and, in certain cases, its right to property (Article 17 of the CFR). The limitations to fundamental rights must be 'necessary and must genuinely meet objectives of general interest recognised by the Union or the need to protect the rights and freedoms of others' (Article 52 of the CFR).[1093] In addition, neither of the parties should invoke their fundamental rights beyond their scope and purpose or to achieve an unjust advantage (Article 54 of the CFR).[1094]

Yet, how to balance the competing interests and needs of clients and firms? In fact, it is not possible as it is in proceedings between public authorities and private parties, to assess whether and to what extent a policy reason (pursued by the authority) can override a fundamental right (of the private party) because both parties can invoke 'general interest' justifications. Rather, as noted by Hugh Collins, it is necessary to undertake a double proportionality test in order to examine the justification for interfering with each right.[1095] This double proportionality test is however particularly complex in financial disputes. In this context, the judge does not only face the 'classical question' of the extent to which public values should encroach into private autonomy but, especially after the financial crisis, he has to deal with the question of the extent to which a public value (the financial stability) should prevail or limit another public value (protection of investors) protected by EU law.[1096]

6.2. The horizontal application of fundamental rights in unfair contract terms disputes

Keeping in mind the difficulties of balancing fundamental rights, it must be remembered that after the global financial crisis, the CJEU has emphasized the

[1093] See, in particular, case C-12/11, *McDonagh*, EU:C:2013:43, para 61. See also the recital No 45 of the Commission proposal for a Regulation on structural measures improving the resilience of EU credit institutions. Brussels, 29.1.2014 COM(2014) 43 final.
[1094] See N. Reich. *General Principles of EU Civil Law*, (2013): 209.
[1095] H. Collins. 'On the Incompatibility of Human Rights Discourse and Private Law', in H.-W. Micklitz (ed.). *Constitutionalization of European Private Law,* p. 50.
[1096] The recital No 11 of the ESMA Regulation which defines both financial stability and investor protection as 'public values'.

importance of EU fundamental rights in several preliminary rulings concerning the UCTD in relation to mortgage loan contracts.[1097]

In the landmark case *Mohamed Aziz*, the CJEU held that Spanish national law, which does not allow a national court to suspend the mortgage enforcement proceeding to review in a declaratory proceeding the unfairness of a contract term upon which the mortgage enforcement is based, does not ensure the effective application of the UCTD. Importantly, the CJEU stressed that this 'applies all the more strongly where, as in the main proceedings, the mortgaged property is the family home of the consumer whose rights have been infringed, since that means of consumer protection is limited to payment of damages and interest and does not make it possible to prevent the definitive and irreversible loss of that dwelling'.[1098] However, this important claim was supported by the (social-oriented interpretation of the) principle of effectiveness, not by the EU fundamental rights ('hidden constitutionalization').[1099]

In *Kušionová* and *Sanchez Morchillo*, the CJEU reiterated that the loss of the family home could not only undermine the rights of the consumer, as individual, but also those of its family members.[1100] However, unlike *Mohamed Aziz*, the CJEU supported this social oriented interpretation of the UCTD by referring expressly to the fundamental rights of Article 7, 38 (in *Kušionová*) and 47 (in *Sanchez Morchillo*) of the CFR ('open constitutionalization').[1101]

This line of judgments transformed the CJEU into a last resort institution capable of acting as 'social engineer' [1102] to 'fix' the remedial and procedural vulnerabilities of the over-indebted consumers and to offset the democratic and social deficit of the

[1097] See, for an overview, F. Della Negra. 'Diritto alla tutela giurisdizionale effettiva e diritti dei consumatori', in P. Gianniti (ed.). *La CEDU e il ruolo delle corti*, *Commentario del codice civile e codici collegati Scialoja-Branca-Galgano*, a cura di G. De Nova, Zanichelli, 2015, p. 1567.
[1098] Case C-415/11, Mohamed Aziz, ECLI:EU:C:2013:164, para 61.
[1099] See H.-W. Micklitz. 'Unfair contract terms – public interest litigation', in E. Terryn *et al*. (eds), *Landmark Cases of EU Consumer Law: In Honour of Jules Stuyck,* Cambridge: Intersentia, 2013, 651.
[1100] Case C-169/14, *Sanchez Morchillo*, ECLI:EU:C:2014:2099, para 43 and case C-34/13, Kušionová, ECLI:EU:C:2014:2189, para 63.
[1101] See F. Della Negra. 'The uncertain development of the case law on consumer protection in mortgage enforcement proceedings: Sánchez Morcillo and Kušionová' 1020.
[1102] H.-W. Micklitz. 'Unfair contract terms – public interest litigation', p. 651.

EU and its Member States.[1103] The CJEU's reference to the consumer's family home shows that the principle of effective judicial protection, *sub species* of effectiveness, was used to broaden the protective scope of the UCTD to third parties; namely, family members who are not parties to the contract but can be affected as much as the consumer by the foreclosure and forced sale of the family home.

This does not mean that the protection of consumers is absolute or unlimited. To the contrary, the CJEU has reiterated that in implementing EU law national courts must also respect the principle of *audi alteram partem*. This is especially so when it decides a dispute on a ground that it has identified of its own motion,[1104] or when a contract terms is declared unfair solely because an equivalent term has been declared unlawful because it was included in a registry of unlawful contract terms.[1105]

6.3. The horizontal application of fundamental rights in mis-selling disputes

Admittedly, there could be some legal obstacles in extending the social-oriented effectiveness and the 'open constitutionalization' of private law to disputes for the breach of the MiFID conduct of business rules.[1106] First, whereas the UCTD's protection regime is centred on the protection of the consumer, irrespective of the type of financial instrument or service purchased, the MiFID's one is dependent upon the type of financial instrument and service offered to him. Also because of its cross-sectoral nature, the UCTD has (unexpectedly) become a powerful tool 'to adjust' and upgrade national private law irrespective of the type of good or service involved in the transaction.[1107]

[1103] See O. Gerstenberg. 'Constitutional Reasoning in Private Law: The Role of the CJEU in Adjudicating Unfair Terms in Consumer Contracts' 21 E*uropean Law Journal* (2015): 619.
[1104] Case C-472/11, *Banif Plus Bank*, EU:C:2013:88, para 29.
[1105] Case C-119/15, *Biuro podróży 'Partner'*, ECLI:EU:C:2016:987, para 27 and 47.
[1106] See, in the affirmative O. O. Cherednychenko. 'Fundamental Rights, European Private Law and Financial Services', p. 251.
[1107] See H.-W. Micklitz and N. Reich. 'The Court and Sleeping Beauty: The revival of the Unfair Contract Terms Directive (UCTD)' 807 and the opinion of Advocate General Wahl in Joined Cases C‑482/13, C‑484/13, C‑485/13 and C‑487/13, *Unicaja Banco SA v José Hidalgo Rueda*, ECLI:EU:C:2014:2299 para 1.

Second, as noted by the Advocate General Jaaskinen in *Banif Plus Bank*, the MiFID aims to protect the investor, namely a person 'who invests or intends to invest his own or borrowed capital in a financial instrument with a view to gaining revenue, or at least protecting the value of his capital' rather than financing consumption (e.g. by borrowing money from the bank).[1108] Following his view, it could be held that the UCTD's protective regime should not apply to those clients who formally qualify as consumers, (because they are natural person acting outside their business, trade or profession) but remain, in substance, investors because their contract is driven by speculation or hedging – not consumption.

Whereas this substantive or economic distinction between consumer and investor offers a useful theoretical yardstick, it cannot be applied strictly in the post-modern financial markets, which are characterised by an increasing substitutability and interdependence between the typical banking products (loans and deposits) and investment products. Not only can a credit institution (if authorized as a MiFID firm) offer also investment services but will often offer investment products (interest rate swaps) to clients in conjunction with banking products (loans) and typical banking products (deposits) can incorporate financial instruments (structured deposits).[1109] In addition to this, in retail markets, not differently to consumer markets, the contract terms are drawn up in advance by the firm and the client is unable to influence the content of the contract terms, leaving him or her with no other choice but to take them or leave them. In this situation, there would be no reason to differentiate the situation of the retail client from that of the consumer because both are exposed to the same kind of information, economic- and bargaining-power asymmetry vis-à-vis the firm.

6.4. Retail client protection and financial stability: To be balanced or not?

Be that as it may, in mis-selling disputes the social-related aspects could lose their centrality as the principle of client self-responsibility potentially gains more importance. In addition to this, in disputes concerning financial instruments, the

[1108] Opinion of the Advocate General Jääskinen in case C-312/14, *Banif Plus Bank Zrt.,* para 22.
[1109] See in particular V. Colaert. 'European Banking, Securities and Insurance Law: Cutting Through Sectoral Lines?', 1579.

balancing test could be more strongly affected by the need of ensuring the safety and soundness of financial firms, which is one of the prerequisites for the stability of the financial system.

6.4.1. The 'financial stability argument': Role and limitations

Indeed, in three judgments handed down in 2016, concerning challenges brought by private parties against measures adopted by national and EU authorities in the context of the banking crisis, the CJEU has underlined that financial stability is an objective of general interest pursued by the EU and as such it can legitimately restrict, in accordance with the proportionality principle, the fundamental rights of depositors, shareholders and investors.[1110]

In the landmark case *Kotnik,* the CJEU was called upon to decide, *inter alia*, whether Directive 2012/30, which establishes that any increase or reduction in the capital of a public limited liability company must be subject to a decision by the general shareholders meeting, precludes the Commission Banking Communication[1111], which provides that certain alterations to the share capital of banks do not have to be decided upon or approved by the general meeting.[1112] The CJEU recognised that the main objective of the Directive is to ensure minimum equivalent protection for both shareholders and creditors of public limited liability companies but decided that the Directive does not preclude Member States from adopting exceptional measures affecting share capital without approval of the general meeting 'in the context of there being a serious disturbance of the economy of a Member State and with the objective of preventing a systemic risk and ensuring the stability of the

[1110] See, also ECtHR, *Dennis Grainger and others vs. UK*, Application no. 34940/10 (2012) where the Court weighted the public interest, protected by the UK Government, in ensuring the financial stability over the fundamental right of property of creditors against the resolution measures adopted in the wake of the Northern Rock failure.

[1111] Commission. Communication on the application, from 1 August 2013 , of State aid rules to support measures in favour of banks in the context of the financial crisis ('Banking Communication') O J C 216/1 (2013).

[1112] Case C‑526/14, *Kotnik and Others*, EU:C:2016:570 (fifth question referred for a preliminary ruling).

financial system'.[1113] More importantly, the CJEU specified that 'although there is a clear public interest in ensuring throughout the European Union a strong and consistent protection of investors, that interest cannot be held to prevail in all circumstances over the public interest in ensuring the stability of the financial system'.[1114] To be sure, the term 'investor' in this context was meant to indicate shareholders and creditors, rather than clients, as the CJEU specified in the *Dowling v Minister for Finance*, where the CJEU decided, in line with *Kotnik*, that a Ministerial Direction Order requiring the increase of the sharecapital without the agreement of the general shareholder meeting, adopted in a situation where there is a serious disturbance of the economy and the financial system of a Member State threatening the financial stability of the European Union, is not in contrast with the Directive 77/91/EEC.[1115]

Nevertheless, the fact remains that in the CJEU' reasoning the interests for the financial stability outweighted that for the protection of the private parties. This is because, as the CJEU clarified in another part of the motivation in *Kotnik*:

'financial services play a central role in the economy of the European Union. Banks and credit institutions are an essential source of funding for businesses that are active in the various markets. In addition, the banks are often interconnected and a number of them operate internationally. That is why the failure of one or more banks is liable to spread rapidly to other banks, either in the Member State concerned or in other Member States. That is likely, in its turn, to produce negative spill-over effects in other sectors of the economy'.[1116]

In the recent *Ledra* case, the CJEU examined the claim for compensation filed by Cypriot depositors against the Commission and ECB in relation to the resolution measures that the Central Bank of Cyprus imposed on them, in accordance with the Memorandum of Understanding (MoU) concluded between the Republic of Cyprus and the ESM on 26 April 2013.[1117] The plaintiffs claimed, in essence, that the Commission and ECB were responsible for the MoU and therefore claimed

[1113] Case C-526/14, *Kotnik and Others*, para 88.
[1114] Case C-526/14, *Kotnik and Others*, para 91.
[1115] Case C-41/15, *Gerard Dowling v Minister for Finance*, ECLI:EU:C:2016:836, para 54.
[1116] Case C-526/14, *Kotnik and Others*, para 50.
[1117] See in detail for the resolution measures: case T-289/13, *Ledra Advertising Ltd v European Commission ECB*, para 17.

compensation equivalent to the diminution in value of its deposit. The CJEU, upholding the orders of the General Court, dismissed the actions for damages.[1118] The CJEU examined, in particular whether the Commission, by including the bail-in measures in the MoU, violated the applicants' right to property under Article 17(1) of the CFR. The CJEU found that the bail-in constituted a restriction of the fundamental right of property but concluded that this restriction was justified based on the general interest in 'the stability of the banking system in the euro area' and that the restriction did not constitute 'a disproportionate and intolerable interference impairing the very substance of the appellants' right to property'.[1119]

Since 'financial stability' remains a vague and malleable legal concept[1120] it is crucially important to determine its boundaries vis-à-vis other objectives of general interest and the EU fundamental rights. A very important corollary of these three judgments is that the stability of the financial system (since it can restrict fundamental rights) cannot be regarded as a purely economic interest, like the promotion of the national economy, which according to settled case law[1121] does not justify in itself a restriction of the EU fundamental rights. However, the factual context of the three judgments suggests some caution in stretching the boundaries of 'financial stability'. In *Kotnik*, the contested measures (writing off equity capital and hybrid capital and subordinated debt) aimed to recapitalize five Slovenian banks whose assets were not sufficient to satisfy their creditors and depositors. In *Dowling* the challenged measure (recapitalization order) was made essential to avoid the failure of an Irish credit institution that would have threatened the financial stability of Ireland and the EU. In *Ledra* the contested measures (bail-in of depositors) was taken in the context of the resolution of two Cypriot banks to ensure the stability of the euro area. To conclude, it is undisputed that the Court's

[1118] Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd et al v Commission and ECB*, ECLI:EU:C:2016:701.
[1119] Joined Cases C-8/15 P to C-10/15 P, *Ledra Advertising Ltd et al v Commission and ECB*, para 70 and 74.
[1120] See in particlar M. Andenas, I. Chiu. *The Foundations and Future of Financial Regulation*, p. 69 and J.H. Dalhuisen. 'The Management of Systemic Risk from a Legal Perspective'in M. Andenas and G. Deipenbrock (eds.). *Regulating and Supervising European Financial Markets*, p. 367.
[1121] See in particular Case C-201/15, *Anonymi Geniki Etairia Tsimenton Iraklis (AGET Iraklis) v Ypourgos Ergasias*, ECLI:EU:C:2016:972, para 72.

reasoning in these cases was driven by the objective of 'financial stability'.[1122] However, the CJEU considered that the restriction of the private law rights of shareholders and depositors was legitimate only as the *extrema ratio* to avoid a more serious damage to the parties themselves, the third-parties and the financial system as a result of the involvency or serious financial deterioration of a systemically important credit institution.

6.4.2. The 'effective protection' argument: Role and limitations

The CJEU has (implicitly) considered the complex relationship between the effective protection objective and the financial stability objective in the landmark *Francisco Gutiérrez Navarro*, mentioned above. It is submitted that this important judgment suggests that that effective judicial protection of consumers cannot be limited by the need of ensuring financial stability when the national judge finds that a contract terms is unfair, and therefore, also when there is a finding that the firm breached its conduct of business rules. In the same vein, *Hirmann v Immofinanz AG* specified that no balance between the interests of the client and the financial firm should be achieved when the financial firm infringed the EU-derived standards of conduct. This *dictum* is particularly important because in this case, unlike *Francisco Gutiérrez Navarro*, the dispute in the main proceedings did not involve a consumer who sought to finance his or her consumption but an investor who purchased a financial instrument (shares) and who would have been classified as retail client under the MiFID. Therefore, *Hirmann v Immofinanz AG* shows that also in mis-selling disputes, involving financial instruments, the public interest in the effective protection of the client, irrespective of his or her formal qualification as consumer or retail client, should prevail over the objective of ensuring the safety and soundness of the defendant financial firms where they have breached a EU-derived conduct rule. It seems reasonable to argue, however, that the rationale of the

[1122] See for an objective-driven judicial reasoning T. Tridimas and N. Xanthoulis. 'A Legal Analysis of the Gauweiler case between Monetary Policy and Constitutional Conflict' 23 Maastricht Journal of European and Comparative Law (2016): 17.

investment (consumption, speculation or hedging) should play a role in balancing the interests of the client and the firm.

Admittedly, it could be more difficult to discard the financial stability objective in case of mis-selling disputes triggered because of insolvency or resolution proceedings of the defendant firm or when the remedy to the mis-selling would cause the insolvency or resolution of this firm. In such a scenario, there is a need to ponder the various types of private and public interest at stake, considering the concrete aspects of the disputes, including the scale and intensity of mis-selling, and the nature (credit or investment firm, systemic or not) of the defendant firm.

6.5. The client protection vs financial stability dilemma: Preliminary conclusions

In conclusion, it is undisputed that in EU post-crisis secondary legislation, the protection of financial stability represents one of the main objectives of crucial substantive (i.e. CRR and CRDIV) and institutional reforms (i.e. ESAs Regulations, ESRB Regulation, SSM Regulation and SRM Regulation).[1123] Some authors go so far as to define financial stability as an 'overriding'[1124] and 'foundational'[1125] objective of EU law thus (implicitly or explicitly) advocating a hierarchical relationship between the financial stability and the investor protection objectives. However, and especially in the absence of an express legal basis in the TUE (in particular, in its Article 3) and in the TFEU, it is doubtful whether the financial stability objective should always prevail or limit the investor protection objective. In *Hirmann v Immofinanz AG* and *Francisco Gutiérrez Navarro* the CJEU underscored that, as a rule, the risk for the stability of financial markets (or the pursue of financial stability) cannot introduce exceptions to the general principle of effective judicial protection granted by EU law to consumers and clients.

[1123] See the recital No 11 of the ESMA Regulation which defines financial stability and investor protection as EU public values.
[1124] K. Tuori and K. Tuori. *The Eurozone Crisis. A Constitutional Analysis*, p. 183.
[1125] G. Lo Schiavo. *The Role of Financial Stability in EU Law and Policy*, p. 3.

This line of judgments therefore suggests that, as a rule, the stability of the financial stability is not a sufficient reason to derogate to the regime of protection laid down by EU secondary law, and supported by Article 38 and 47 of the CFR, for consumers and investors. Only exceptionally, namely when the insolvency or resolution of a systematically relevant credit institution is at stake, the stability of the financial system can restrict, subject to the principle of proportionality, the private law rights, remedies as well as the EU fundamental rights.

Chapter 9 – CONCLUSION: FROM AUTONOMY-BASED TO REGULATION-BASED PRIVATE LAW AND ENFORCEMENT IN EU RETAIL FINANCIAL MARKETS

1. The new institutional context: From national *ex post* to EU *ex ante* contract governance

Before the global financial crisis, EU regulators had (implicitly) relied on an *ex post* model of governance, by delegating supervision and public and private enforcement to national law and institutions.[1126] This 'delegation' took place through the harmonization of right-conferring rules and some procedural rules (i.e. out-of-court dispute resolution). In the wake of the financial crisis, this regulatory technique has (unexpectedly) become a formidable tool for national courts and adjudicators to tackle the firms' mis-selling, by transforming the traditional autonomy-driven national private law and enforcement into instruments to achieve regulatory objectives, namely the protection of retail clients. As a result, litigation and dispute resolution, the typical *ex post* institutional reactions to mis-selling, have become hybrid institutional instruments to assess the compliance of the firms, not only with their contractual obligations but also with their regulatory duties, set down by regulators to steer their conduct *ex ante.*

The EU post-crisis responses, mainly driven by financial stability concerns, introduced new *ex ante* modes of contract governance, such as new command-and-control product and conduct regulation and statutory limitations of private law remedies especially vis-á-vis key financial market actors (Credit Rating Agencies, CCP, issuers). Although it is early to assess how national courts and ADRs will react to this 'stability driven private law', it could be argued that these post-crisis measures introduce a new and more intense form of instrumentalization, based on the model of substitution, because they replace national private law with a new, stability-driven 'EU private law'.

[1126] D. Kelemen. *Eurolegalism. The Transformation of Law and Regulation in the European Union*, p. 138.

The key finding of this thesis is that this 'change of the location of control'[1127] from the national *ex post* mechanisms to the EU *ex ante* governance not only affected public enforcement and supervision but also private law and enforcement in retail financial markets, determining the instrumentalization of private law and enforcement.[1128] Against this backdrop, this last chapter aims to summarize the earlier findings and to bring together the main themes of the discussion, illustrating first the reasons why the instrumentalization is necessary and second its conceptual and legal implications.

2. The limitations of traditional private law and private enforcement

The acknowledgment that private law rights and remedies can be driven not only by the objective of ensuring the parties' autonomy but also by regulatory objectives requires further clarification as to why this instrumentalization is necessary. To put it otherwise, we need to ask why the same objectives cannot be achieved by using traditional private law or traditional command-and-control financial regulatory tools.

The foregoing has shown that traditional private law and enforcement mechanisms are in themselves ill-suited to protect retail clients against mis-selling as well as to consider wider third party or systemic implications. The traditional private law rules (in particular, on causation and burden of proof) can make it excessively difficult for retail clients to recover the damages suffered as a result of the firm's mis-selling. The traditional private enforcement (i.e. court enforcement) is subject to the well-researched problems of access to justice, slow judicial procedures and lawyers' rent–seeking.[1129] Moreover, the court enforcement cannot ensure the private costs/benefits are aligned with the social costs/benefits because a private parties "do not take into account the legal costs that he induces others to incur, nor does he recognize associated effects on deterrence and certain other social

[1127] N. Moloney. 'Financial Markets Regulation', p. 771.
[1128] See also J. M. Smits. 'Private Law in a Post-National Society. From Ex Post to Ex Ante Governance' Maastricht European Private Law Institute Working Paper No. 2013/2.
[1129] See, in particular, H. Jackson and M. Roe. 'Public and Private Enforcement of Securities Laws: Resource- Based Evidence', 207.

benefits".[1130] Both over-deterrence and under-deterrence could be a source of systemic risk; the former because, as a result of excessive civil law sanctions, can deplete assets of the competitor firms, the latter because it reduces the dissuasive effect of enforcement and undermines the confidence of the investors in the financial markets and the legal system. The judge (and traditional private and procedural law), however, is not the best placed institutional actor to avoid sources of systemic risk because he must decide upon the plaintiff' contractual or tortious claim against the defendant and has no duty to consider the wider third-party effects of the lawsuit.[1131]

3. The limitations of the EU investor protection regulation and supervision

However, investor protection regulation (particularly conduct of business rules) and supervision, have structural limitations too. First, it should be noted that, the regulatory design of the EU investor protection rules is the result of a complex balancing between the 'empowering investor', 'protecting investor' and 'financial stability' objectives.[1132] Precisely because the rules are calibrated *ex ante* to avoid excessive implementation costs for the industry and to promote a proportionate and sufficiently clear legal framework, they could discard concrete aspects of the clients' vulnerability (e.g. age, economic conditions, cognitive limitations) which could, instead, emerge *ex post* in the adjudication of the dispute.[1133]

Second, the increasing level of detail, granularity and prescription of conduct of business and other investor protection rules risks creating regulatory gaps which could be exploited by abusive markets conduct. A more responsive approach to

[1130] S. Shavell. 'The Fundamental Divergence between Private and Social Incentive to Use the Legal System', 575 and, recently, F. Weber and M. Faure. 'The Interplay between Public and Private Enforcement in European Private Law: Law and Economics Perspective' 4 European Review of Private Law (2015): 533.
[1131] On the inadequacy of courts in financial markets, but essentially for their lack of expertise and incentives, see E. Glaeser, S. Johnson, A. Shleifer. "Coase versus the Coasians' 116 Quarterly Journal of Economics (2001): 854. See also R. J. Gilson, C. F. Sabel and R. E. Scott. 'Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Forms' 188 New York University Law Review (2013): 171.
[1132] See Chapter 2, above.
[1133] See Chapter 7, above.

conduct regulation, in decline after the financial crisis,[1134] could only mitigate (but not eliminate) the risks of abusive conduct. As matter of fact, the two recent judgements of the CJEU in *Banif Plus Bank Zrt. v Márton Lantos* and *Mohammad Zadeh Khorassani v Kathrin Pflanz* – where the CJEU supported a resctrictive view of the MiFID I's protective scope – were handed down in relation to the MiFID I which adopted a principle-based approach to distribution regulation.[1135]

Turning now towards the limitations of supervision and public enforcement, while supervisory authorities can take action when the individuals would not have enough incentives to act and can benefit from technical expertise, they are increasingly constrained by budgetary and staff limitations and they could be vulnerable to political and lobby pressures. In addition to this, after the global financial crisis, and in the new era of the Banking Union, dominated by imperative need of ensuring financial stability, the consumer protection mandate of supervisors risks being watered down by the overriding micro and macro-prudential considerations. Moreover, since in EU conduct supervision remains decentralized, the balance between prudential and consumer protection objectives is made at the national level with a risk that crucial supervisory decisions, including authorizations for opening of new activities, or restrictions to product distributions, which could have a cross-border impact are made taking into account only domestic factors.

4. The hybridization of private law and private enforcement: Implications

4.1. Private law duties and remedies: 'Regulated empowerment'

It is argued therefore that hybrid private law remedies and procedures offer a normative solution to offset the weaknesses of traditional private law and financial regulation and to reconcile the procedural autonomy of Member States with the need of ensuring the effectiveness of EU law and the effective protection of the EU fundamental rights. Conceptually, the hybridization of private law and enforcement

[1134] See in particular J. Black.'The Rise, Fall and Fate of Principles Based Regulation' LSE Law, Society and Economy Working Papers 17/2010.
[1135] See N. Moloney. "The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?', 176.

entails a 'moderate instrumentalization' of private autonomy which, unlike the extreme variant of instrumentalization (substitution model), does not absorb private law into public law nor it makes the regulation of retail financial markets wholly dependent on the choices made by financial regulators and supervisory authorities.

The distinctive feature of hybrid private law, in comparison to financial regulation, is that it empowers the individual to vindicate his or her rights.[1136] This empowerment, however, is regulated: (i) to protect retail clients (e.g. through out-of-court dispute resolution and the conform interpretation); and (ii) to ensure the safety and soundness of financial firms and the stability of the financial system (e.g. through the restriction of the private law remedies such as restitutions that investors would enjoy under traditional private law, when such remedies would lead to over-deterrence and therefore to increase systemic risks).

Hybrid private law, differently from supervision, which is bound by detailed regulatory standards, can customize the remedy on the effective need for protection of the retail client. The general concepts of private law (e.g. duty of care, duty of good faith) allow the judge or the other adjudicator to craft *ex post* the remedy but taking into account the financial regulatory standards set out *ex ante* by the regulator.[1137] Finally, it should also be noted that a hybrid private law entails a pluralistic conception of private law,[1138] which admits the co-existence of different variations of instrumentalization even within the same legal system. Whilst in the retail markets the autonomy-based private law has been replaced by a regulated-driven private law, in the wholesale markets, the autonomy-based private law maintains its function of ensuring the self-responsibility of sophisticated clients and leaving a certain margin of manoeuvre to the parties to innovate financial products and contracts.[1139]

[1136] See, in particular, H.-W. Micklitz, G. Comparato, Y. Svetiev. 'The Regulatory Character of European Private Law', 67.
[1137] See, for a different view, A. Tuch. 'Conduct of Business Regulation, 541.
[1138] See H. Dagan. 'Autonomy, Pluralism and Contract Law Theory', 15 and H.-W. Micklitz. 'Monistic Ideology versus Pluralistic Reality', p. 29 and M. W. Hesselink. 'Contract theory and EU contract law', 532.
[1139] See Chapter 6, above.

4.2. Private enforcement: Institutional transformations

Whilst a legal system focussed on the protection of private autonomy requires a minimal enforcement structure (based on courts), a system centred on the protection of public interest objectives (e.g. the protection of clients and the stability of the financial system) needs an enhanced enforcement structure to ensure that the vulnerable parties have effective access to justice and that the private parties, in pursuing their own own interests, do not undermine the public interest (e.g. throguh vexatious litigation).

The hybrid private law has an impact also on traditional private enforcement and supervision. The hybridization of private law transforms litigation, traditionally conceived as a system of *ex post* rule-setting, into a mixed-system of *ex post* and *ex ante* rule-setting[1140] because the courts decide the dispute *ex post* (i.e. after the occurrence of the damage) but with standards aimed to steer *ex ante* the conduct of the market participants. As a result, national courts traditionally depicted as 'reactive' institutions become *lato sensu* 'proactive' institutions, because by applying regulatory standards, they take into account the wider repercussions for markets and the financial system of firms' misconduct.[1141] Second, the centrality in the governance of retail financial transactions of a fully-fledged proactive institution, such as supervisors, increases. This is because as the ECtHR held in *Grainger*[1142] '[given] their direct knowledge of their society and its needs, the national authorities are in principle better placed than the international judge to appreciate what is 'in the public interest'. Third, the ADRs, whilst formally driven by the initiative of private parties, have become a fundamental tool to enforce financial regulation and therefore to take into account the third-party effects of mis-selling.

[1140] See O. O. Cherednychenko. 'Public Supervision over Private Relationships', p. 53.
[1141] See C. Xu, K. Pistor. 'Law Enforcement under Incomplete Law: Theory and Evidence from Financial Market Regulation', p. 35.
[1142] ECtHr, Dennis GRAINGER and others against the United Kingdom, Application no. 34940/10, para 36.

However, these three forms of hybrid enforcement remain largely unconnected.[1143] It is advocated that the EU should introduce mechanisms to coordinate private and public enforcement in order to ensure that private enforcement is not a mere vehicle for individual rent-seeking and that supervision/public enforcement take into due account the need of protecting retail clients.[1144] To make the consumer objective of supervisory authorities more effective, the ESMA should be conferred the power to settle cross-border client disputes and to take action under Article 17 of the ESMA Regulation when this is necessary to ensure the effective protection of investors. In addition, to align the private enforcement with the need of ensuring the public interest in investor protection and financial stability, there could be a need to introduce rules which require national and Union courts to take into account (but not necessarily to follow) the decisions adopted by national and EU supervisory authorities. This form of 'sequential' enforcement would ensure a minimum level of coordination between courts and supervisors, without prejudice of the national courts' right to deviate from the supervisory decision, for justified reasons.

5. Balancing client protection and financial stability: Challenges and perspectives

5.1. The new retail markets risks

The post-crisis era requires regulators, supervisors and adjudicators to take into account the third-party effects (or externalities) of mis-selling. Mis-selling indeed generates both direct externalities (i.e. loss of investors' confidence in financial markets) and indirect externalities (i.e. weakening of the defendant firms solvency and profitability), which are the result of the private and public enforcement actions taken against the financial firm.[1145] Therefore, paradoxically, whereas traditional private law and enforcement reduce the direct externalities, through its deterrent effect, they can increase the indirect externalities because civil law sanctions could weaken the solvency and profitability of financial firms, thus increasing systemic risks.

[1143] See also, with reference to general EU law, F. Wilman. *Private Enforcement of EU Law Before National Courts*, p. 492.
[1144] See also M. Andenas, I. Chiu. *The Foundations and Future of Financial Regulation*p. 331.
[1145] See Chapter 1, above.

The model of hybridization could solve this paradox namely (i) by making it possible for litigation and dispute resolution to take into account these systemic concerns in litigation and dispute resolution and, conversely, (ii) by asking national and EU supervisory authorities to take into account the client protection implications of prudential supervision. For both the reactive and proactive institutions the vexed question remains how to achieve a high level of client protection and deterrence without jeopardizing the safety and soundness of financial firms and the stability of the financial system.

Notably, on the practical level, this balancing is made difficult also by the increasing risks faced by retail clients as a result of the post-crisis financial stability-driven policies (i.e. increased capital requirements) and macro-prudential environment (i.e. low interest rates). The regulatory pressure on financial firms to meet the new prudential requirements introduced by the CRR (own funds), BRRD and SRM Regulation (minimum requirement for eligible liabilities) could push firms to broaden the target market for these products as to include vulnerable retail clients and to engage into more aggressive distribution practices. The current low interest rate environment triggers the client's demand for more complex (and thus more risky) financial products and leads financial firms to increase the price of fees and commissions to sustain their profitability. The increase of clients' complaints to the NCAs on hybrid and debt securities and fees and commissions reveals, as the ESMA recently reported, the concrete nature of these 'new retail market risks'. [1146]

5.2. The criteria for the balancing test

On the theoretical level, the most difficult problem of this balancing test is that, after the crisis, the reduction of systemic risk and the protection of financial stability have become statutory objectives of EU secondary law and both the stability of the financial system and the protection of investors are regarded as EU law 'public values' .[1147] The upgrading of the financial stability-related concerns from the policy to the EU legislative level, raises the crucial question of how the

[1146] ESMA. *Report on Trends, Risks and Vulnerabilities* No. 1, 2017, p. 37 and 42.
[1147] See the recital No 11 of the ESMA Regulation.

financial stability objective should be balanced, and if so, with other statutory objectives of EU law, in particular, investor protection. The need of reconciling the protection of clients with the protection of third-parties could arise, in a forward-looking perspective, when mis-selling disputes are triggered as a result of the insolvency or resolution of the defendant firm (which mis-sold financial instruments) or when the remedy to compensate the loss suffered by the client would worsen the solvency of the firm. It has been argued that, in the absence of an express legal basis in the TUE (in particular, in its Article 3) and in the TFEU, it is doubtful whether the financial stability objective should always prevail or limit the investor protection objective. Furthermore, whereas the protection of investors, can be supported by Article 47 of the CFR, and if the investor qualifies as a consumer, also by Article 38 of the CFR, the stability of the financial system does not rank *per se* as a EU fundamental right and therefore, as a rule, should not be balanced with the EU fundamental rights. Judgments like *Francisco Gutiérrez Navarro* and *Hirmann v Immofinanz AG*, mentioned above, support the view that when a financial firm breached its conduct of business rules, the need to ensure the effective protection of the client prevails over the need of ensuring the financial stability. The balancing can be necessary only in exceptional circumstances, also justified by the general interest, for example, when the insolvency or resolution of a systematically relevant credit institution is at stake. In this scenario, there is therefore a need to ponderate the various types of private and public interets at stake, taking into account the concrete aspects of the disputes, including the scale and intensity of mis-selling, the nature of the client (consumer or investor) and the nature of the defendant firm (credit or investment firm, systemic or non-systemic).

6. Concluding remarks

The described ongoing process of instrumentalization shows that private law and private enforcement have already become an integral part of EU retail market regulation and therefore they are necessary tools to achieve a stable financial market and ensure a high level of investor protection. This instrumentalization increases the centrality of the 'proactive' institutions, such as regulators and supervisory authorities, (also) in the governance of private law relationships, and

calls traditional 'reactive' institutions, such as courts and ADRs, to take into account the third-party effects of mis-selling. In the EU legal order, the infusion of financial stability-related concerns in private law adjudication should, however, be counter-balanced by the need of ensuring the effective protection of investors.

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