LLM Thesis for International Business Law

Suitable and Appropriate Investor Protection?

Compensation for retail investors in case of mis-selling of financial instruments caused by infringements of the conduct of business rules of the MiFID II framework

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Date: 1 June 2019, Place: Brussels

Abstract:

Financial markets are of great significance for the European economy and society and, therefore, also an essential part of the everyday life of Union citizens. As more and more Union citizens are active in financial markets, it is necessary to have a set of clear and harmonized rules to protect citizens in their capacity of (retail) investors. Such protection is afforded by the MiFID II conduct of business rules, governing the activities of financial service providers in protecting the interest of their clients and the integrity of the market. Despite the extensive regulatory and supervisory framework of investor protection, mis-sellings still occur, resulting in possibly tremendous damage for (retail) investors. When mis-sellings occur because of violations of conduct of business rules, aggrieved investors should have the right and the means to receive compensation for the damages they incurred. Even though Article 69 of MiFID II refers to a right of redress for aggrieved investors, it does not give any guidance as to how such a right should be exercised. The determination of the potential contractual consequences of a breach of MiFID rules as well as the appropriate institutions and remedies for such breaches remains under the discretion of EU Member States. In the absence of EU law providing for sanctions for violations of the conduct of business rules, investors are dependent on their national systems. However, these systems strongly differ from one state to another, resulting in inequality with regard to access to justice and ease of obtaining relief. Moreover, there is a general reluctance of investors to start private litigation, since this is a lengthy, costly, complex and financially risky process. The EU legislator has expressed its wish to improve access to justice and ease of obtaining relief for consumers (including in financial services disputes). It has taken several initiatives to this end, for instance it has brought forward the ADR Directive, the ODR Regulation, the FIN-NET platform and most recently the Commission's proposal for a New Deal for Consumers. Nevertheless, as will be argued by this thesis, these initiatives are not always efficient in achieving their objectives. Given the current lack of easy and efficient access to (private) redress mechanisms and the inability of present EU initiatives to significantly improve the situation, other (public) redress systems should be preferred. This thesis argues for the facilitation of regulatory redress, i.e. redress that is ordered or brought about by the intervention of public enforcers. It uses two examples to demonstrate the efficiency and effectiveness of regulatory redress: the redress powers of the United Kingdom's FCA and the settlement between the Belgian FSMA and the bank BNP Paribas Fortis. This thesis concludes that regulatory redress mechanisms should be advanced either through ESMA's Opinions or Guidelines (or other tools aiming at 'voluntary' supervisory convergence) or by promotion of the FCA's redress system and the FSMA-BNP Paribas Fortis precedent as best practice.

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Introduction

The issuance and trading of financial instruments is vital to ensure the availability of capital in the economy and to ensure that capital is efficiently located. Financial instruments allow economic agents to raise funds, to help them grow or innovate. They allow investors to invest their financial surplus and to seek financial returns. And they allow all kinds of entities to manage their risks. Together with services provided by banks, the market in financial instruments is the backbone of modern economies and essential to feed economic growth and innovation.[1] The creation of a single financial market, to improve the free flow of capital and so facilitate the accumulation of capital and to contribute to economic growth, has been the overall objective of the EU in this field for several decades.

Ever since the introduction of the European passport, by virtue of which banks, investment firms and other financial actors can offer their services throughout the EU without the burden of complying with local regulatory requirements, the EU legislator has continued to further the integration, competitiveness, and efficiency of EU financial markets. To create a true ‘level playing field’ which offers also a high degree of protection to investors, the provision of investment services across the EU is subject to compliance with certain organisational and reporting requirements as well as comprehensive rules designed to ensure investor protection.[2] The body of these rules and requirements is laid down in the recently updated Markets in Financial Instruments Directive (MiFID II)[3] and its implementing standards. This makes MiFID II a cornerstones of financial markets regulation, aiming to establish an increasingly safer, sounder, more transparent and more responsible financial system.[4]

One of the main aspects of MiFID II is the introduction of an extensive catalogue of substantive requirements – the so-called “conduct of business rules”- governing the activities of financial service providers in protecting the interest of their clients and the integrity of the market.[5] The MiFID II conduct of business rules build on three overarching principles: the principle of loyalty (investment firms must

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[1] European Commission, ‘Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments’ COM (2011) 656 final, p. 3.

[2] Ibid., p. 5.

[3] 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.

[4] European Commission, ‘Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank: Regulating financial services for sustainable growth’ COM (2010) 301 final; European Commission, ‘Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]’ COM (2011) 656 final, p. 2; European Commission, ‘Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments’ COM (2011) 656 final, p. 6.

[5] For the exact definition of “conduct of business” rules, see: IOSCO, ‘International Conduct of Business Principles’ (July 1990) nr. 18. See also E. Avgouleas, ‘The Harmonisation of Rules of Conduct in EU Financial Markets: Economic Analysis, Subsidiarity and Investor Protection’ (2000) 6 European Law Journal 72, p. 74; C. Cruickshank, ‘Is there a Need to Harmonise Conduct of Business Rules?’ in G. Ferrarini, *European Securities Markets: The Investment Services Directive and Beyond* (Kluwer Law International 1998) 131.

act honestly, fairly and professionally in the best interest of their clients), the principle of informed consent (investment firm must adequately disclose to their clients relevant material information, which is fair clear and not misleading) and the know-your-customer principle (investment firms must provide services that take account of the individual circumstances of their clients, including their knowledge and experience in the investment field, their financial situation and their investment objectives). These principles are set out and elaborated upon in numerous more detailed rules under MiFID II and its implementing standards.

The amount of protection investors enjoy under these conduct of business rules depends on their professionality (retail investors deserve more protection than professional investors or eligible counterparties) and the type of services requested (when requesting execution-only services investors are awarded less protection than when requesting investment advice or portfolio management). This thesis focuses on the protection of retail investors, who deserve the highest level of protection as they lack comprehensive knowledge and experience in the investment sector. As a consequence, they may not always be able to read, absorb or correctly process the available information. At the same time, they also deserve extra protection as their participation in the financial markets is largely dependent on financial intermediaries, which may not always act in their best interest. The conduct of business rules are designed to cope with such problems as information asymmetry and conflict of interest. The extensive set of information duties and other, more substantive requirements included in the conduct of business rules aims to ensure a high level of investor protection and to contribute to investor trust in financial markets.

However, as the Commission itself acknowledges, good investor protection rules alone do not guarantee good investment decisions.[6] The existence of such rules alone is not sufficient to secure a high level of investor protection. To ensure effective investor protection, there needs to be a system for effective enforcement, information for and education of investors and adequate tools for investors to seek redress when violations have occurred. While the EU has some of the strongest rules on investor protection in the world, practical experience shows that it can be difficult to enforce them fully in practice. Even though the public enforcement system has undergone substantial changes after the financial crisis, many MiFID violations continue to occur unabated.[7] The result is that investors may be mis-sold financial

[6] European Commission, 'Communication on EU Consumer Policy Strategy 2007–2013: Empowering Consumers, Enhancing Their Welfare, Effectively Protecting' COM(2007) 99 final, para 22.
[7] For examples I would like to refer to, for instance: Better Finance, *A major enforcement issue: the mis-selling of financial products* (Briefing Paper April 2017); Policy Department for Economic, Scientific and Quality of Life Policies, at the request of the ECON Committee, *Mis-selling of Financial Products: Subordinated Debt and Self-placement* (IP/A/ECON/2016-17, 2018).

products which are not suitable or appropriate for them or may make investment choices which are not optimal.[8]

In such cases it is important that investors are given the tools to enforce their rights and to get compensation. It must be ensured that investors in all Member States have the right to claim individual remedies (e.g. financial compensation or termination of contract) when they are affected by conduct of business violations. However, the analysis of the current legislative framework raises serious concerns about its ability to empower retail investors to make active use of their rights. Being primarily focused on public enforcement of the investor protection rules, MiFID II insufficiently addresses the needs of individual retail investors in the different EU Member States. In fact, for the (private) enforcement of their rights, investors are dependent on their domestic systems. However, these systems strongly differ across the EU, resulting in inequality with regard to access to justice and ease of obtaining relief.

With the ADR Directive, the ODR Regulation and the recent Proposal for a New Deal for consumers, the EU legislator aims to facilitate and harmonize cheap, easy and fast mechanisms for dispute resolution. However, as this thesis will argue, these initiatives as they are now are not sufficient to adequately reach their objective. As a consequence, investors still lack effective and efficient (private) redress possibilities. This thesis therefore concludes that other, public systems should be preferred. In specific, it argues that the institution of regulatory redress systems, through which redress is ordered or brought about by the intervention of public enforcers, is desirable.

[8] Experience from the financial crisis showed that, even in individual cases, damages for mis-sellings could run into millions and millions of euros. European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 114.

CHAPTER 1: MiFID II and Investor Protection

1.1 Introduction

On 1 November 2007, the Markets in Financial Instruments Directive (MiFID)[9] entered into force in the European Union. The framework established by MiFID is one of the cornerstones of the EU's regulation of financial markets, seeking to improve the competitiveness of EU financial markets by creating a single market for investment services and activities and to ensure a high degree of harmonised protection for investors in financial instruments.[10] The framework covers, *inter alia*, the authorisation and the supervision of investment firms, the requirements for the provision of investment services and activities, the authorisation and supervision of trading venues and the requirements for trading activities of financial instruments across the EU.

Recently the Directive has been revised and as from 3 January 2018 the new Directive (MiFID II)[11] entered into force. Together with the new Directive, a new Regulation (MiFIR)[12] was introduced. The regulatory framework established by the new Directive, the Regulation on markets in financial instruments and their implementing measures[13] is commonly referred to as "MiFID II".

MiFID II aims to reinforce the rules on securities markets by ensuring that organised trading takes place on regulated platforms, introducing rules on algorithmic and high frequency trading, improving the transparency and oversight of financial markets and enhancing investor protection and improving conduct of business rules as well as conditions for competition in the trading and clearing of financial instruments. It is a major overhaul of the previously existing law, building on and extending the scope of MiFID I. While the main changes introduced by MiFID II focus on market infrastructure,[14] there are also many changes made in the field of investor protection, which is the topic of this thesis. Even though in respect of investor protection there are only few macro changes, there is a substantial amount of

[9] 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.
[10] See *inter alia*: European Securities and Markets Authority (ESMA), *Discussion Paper MiFID II/MiFIR* (Discussion Paper, ESMA/2014/548), p. 12.
[11] 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.
[12] Regulation (EU) 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.
[13] There is an extensive list of delegated acts, regulatory and implementing technical standards. See in particular: Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU 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; Commission Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.
[14] J. Herbst et al., 'MiFID II/MiFIR series: investor protection (conduct of business)' (*Norton Rose Fulbright*, May 2015) <https://www.nortonrosefulbright.com/en/knowledge/publications/aa4c19c6/mifid-ii-mifir-series> accessed 24 March 2019.

micro changes which, together, represent a very significant regulatory reform in this area. All in all, the rules of MiFID II and its implementing standards form a thick layer of EU requirements applicable to investment firms when providing investment services or performing investment activities in the European Union.

1.2 MiFID II: Regulatory background and context

Before we can discuss the MiFID II framework in detail, it is good to have a look at the legal background and context of MiFID II. MiFID II replaces and updates MiFID I, which was introduced in 2007 and which, in its turn, was a replacement for the Investment Services Directive (ISD)[15]. The ISD – being the first successful effort after 30 years of debate to create a common regulatory regime for investment services- had introduced a 'European passport' for investment firms to offer their investment services within the EU based on a licence granted by the home regulator. By virtue of this 'new' European passport, banks, investment firms and other financial actors covered by the regulatory framework are allowed to do business in the European Economic Area (EEA), without the burden of complying with local regulatory requirements.

Naturally, this elimination of barriers to cross-border trading of securities greatly facilitates cross-border investment services in Europe – as financial actors covered by the framework have the freedom to sell their products and services throughout the EEA without the need to seek a separate authorisation from the competent authority in the Member State where they wish to provide such services or perform such activities-, but it also poses many risks. Harmonization of certain rules that the financial actors have to comply with is essential to ensure a sound financial system with proper protection for investors.

ISD already stipulated some minimum (organisational) rules and requirements applicable to investment firms, but left a great deal of discretion to individual member states.[16] This meant that the majority of the rules applicable to investment firms remained country specific and thus could strongly differ from place to place. This proved to be an impediment to cross-border trade.

MiFID I was intended to overcome these harmonization problems and to provide for similar rules for financial actors. To do so, MiFID I created consistent regulations for investment services across the member States of the EEA, with all participants subject to a similar regime. MiFID I retained the principles of the European passport introduced by the ISD, but increased harmonisation.[17] It thereby

[15] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field.
[16] Price Waterhouse Coopers (PWC), R. Janssen, A. Killian, T. Loonen, *MiFID II: Suitability and Appropriateness Practical guidelines for investment services* (2016), p. 6.
[17] *Nota bene*, it is disputed whether MiFID I adopted a maximum harmonization approach. Even though the legal text is not clear about this, some scholars uphold that it is a maximum harmonization measure, due to the tight phrasing. See: J.P. Casey & K. Lannoo, 'The MiFID Implementing Measures: Excessive detail or level playing field?' (2006) ECMI Policy Brief No. 1.

intended to further integrate the European financial markets, and create a real level playing field for all European stakeholders.[18]

The financial crisis of 2008, however, exposed several weaknesses in the regime.[19] The crisis clearly demonstrated the need to have stricter financial regulation and supervision, whether in relation to lending to consumers, securitisation and repackaging of risks by banks or oversight of (professional) investors and trading of financial instruments including complex instruments.[20] The need for stricter rules was recognized not only at EU level, but has also been stressed by the G20.[21]

At the same time, it became evident that the MiFID framework had to be adapted to new market reality. The more competitive landscape had given rise to new challenges; market and technological developments had outpaced various provisions of MiFID.[22] Eventually, the weaknesses exposed by the financial crisis together with the rapid innovation and growing complexity in financial instruments underlined the importance of up-to-date rules.

All this led to the review of MiFID by the European Commission in 2009-2010. Following a consultation paper[23] which was published by the Commission in December 2010, the Commission made a formal proposal for revision of the MiFID in 2011, which after an extensive legislative process, was agreed in 2014.

1.3 MiFID II: Objectives

1.3.1 *Statement of reasons for review and problems to be solved*

MiFID II was introduced in the aftermath of the financial crisis. Market developments and experience amid the financial crisis had demonstrated that the key organising principles of MiFID needed

[18] P. Bérès, Chair of the Economic and Monetary Affairs Committee, European Parliament, (European Commission's Public Hearing on Non-Equities Markets Transparency, 11 September 2007).
[19] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 4-5; European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank: Regulating financial services for sustainable growth' COM (2010) 301 final; Financial Services Authority (FSA), *The Turner Review: A Regulatory Response to the Global Banking Crisis* (2009); The High-level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, *Report* (2009).
[20] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 4; European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final, p.2.
[21] G20 leaders statement (The Pittsburgh Summit, 24-25 September 2009) <http://www.g20.utoronto.ca/2009/2009communique0925.html> accessed 10 March 2019.
[22] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 5; European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final, p.2.
[23] European Commission, Director General Internal Market and Services, *Public consultation: review of the markets in financial instruments directive (MiFID)* (2010).

updating.[24] This was not only relevant to the review of MiFID, but it was reflected in all major EU reforms of that time in the financial service area, including the review of the Market Abuse Directive[25] and the proposals on OCT derivatives, central counterparties and trade repositories[26], and on short-selling and certain aspects of credit default swaps[27].[28] The MiFID review was thus part of a great transformation of regulation in all areas related to financial markets, aiming to establish a safer, sounder, more transparent and more responsible financial system.[29]

The MiFID review was considered to be "*an essential vehicle for delivering on the G20[30] commitment to tackle less regulated and more opaque parts of the financial system, and improve the organisation, transparency and oversight of various market segments*"[31]. It was meant to improve oversight and transparency of the financial markets in order to ensure fair competition and efficient markets.[32] At the same time, review (and enhancement) of the investor protection framework was considered necessary in order to support investor confidence. Additionally, in accordance with recommendations of the De Larosière group[33] and the conclusion of the ECOFIN Council,[34] updated regulation needed to further minimise discretions available to Member States across EU financial services directives and establish a single rulebook for EU financial markets. The objectives hereof being to further develop a level playing field for EU Member States and financial actors, to improve supervision and enforcement, to

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[24] European Commission, Director General Internal Market and Services, *Public consultation: review of the markets in financial instruments directive (MiFID)* (2010).
[25] Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse.
[26] European Commission, 'Proposal for a Regulation of the European Parliament and of the Council on OTC directives, central counterparties and trade repositories' COM (2010) 484 final.
[27] European Commission, 'Proposal for a Regulation of the European Parliament and of the European Council on short selling and certain aspects of credit default aspects' COM (2010) 482 final.
[28] European Commission, Director General Internal Market and Services, *Public consultation: review of the markets in financial instruments directive (MiFID)* (2010).
[29] European Commission, 'Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the European Central Bank: Regulating financial services for sustainable growth' COM (2010) 301 final; European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final, p. 2; European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 6.
[30] G20 leaders statement (The Pittsburgh Summit, 24-25 September 2009) <http://www.g20.utoronto.ca/2009/2009communique0925.html> accessed 10 March 2019.
[31] European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final, p. 2; European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 6.
[32] European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final, p. 2; European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 6.
[33] The High-level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, *Report* (2009).
[34] European Council, *Council conclusions on strengthening EU financial supervision*, (DG G I 10862/09, 2009).

reduce costs for the market participants and to enhance global competitiveness of the EU financial industry.[35]

This very wide statement of reasons for MiFID review has been supplemented by the aim to address and solve the following problems: (i) lack of a level playing field between markets and market participants which has become exacerbated as new players and new trading techniques developed (ii) difficulties for SMEs to access financial markets (iii) lack of sufficient transparency of the financial markets for market participants (iv) lack of sufficient information and powers for national regulators regarding financial markets and intermediaries, and inconsistent supervisory practice (v) existence of areas in which investor protection has revealed deficiencies and (vi) weaknesses in some areas of the organisation, processes, risk control and assessment of some market participants.

MIFID review was thus intended to address and improve many different issues that were experienced in the years preceding the reform. This thesis is not aimed at describing all drivers, problems and consequences of the problems occurred and solutions proposed at length, and will therefore not analyse all problems specified. For this, the MiFID Impact Assessment can be consulted.[36] The next paragraph will however briefly touch upon the general, specific and operational objectives of the MiFID review, so as to give a somewhat more precise idea of what MiFID II intended to achieve.

1.3.2 *General, specific and operational objectives*

To tackle the problems that were encountered in the years prior to the MiFID revision, the Commission set forth a number of objectives. In doing so, it made a distinction between general, specific and operational objectives. The general objectives are the objectives overarching the specific and operational objectives. They are: (i) strengthening investor confidence, (ii) reducing the risks of market disorder; (iii) reducing systemic risks; and (iv) increasing efficiency of financial markets and reduce unnecessary costs for participants.

To reach these general objectives, certain more specific policy objectives have to be achieved: the EU needs to ensure a level playing field between market participants; to increase market transparency for market participants; to reinforce transparency towards and powers of regulators in key areas and increase coordination at European level; to raise investor protection and; to address organisational deficiencies and excessive risk taking or lack of control by investment firms and other market participants.

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[35] European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final, p. 2; European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 6.
[36] For an extensive analysis of these problems, see European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 9-18.

In its turn, the specific objectives require the attainment of certain operational objectives. The operational objectives are: regulating appropriately all market and trading structures while taking into account the needs of smaller participants; setting up a relevant framework around new trading practices; improving trade transparency for market participants on equities and increasing it for non-equities market; reinforcing transparency towards and powers of regulators; improving consistency in the implementation of rules and coordination in supervision by national regulators; improving transparency and oversight of commodities derivatives markets; reinforcing regulation on products, services and services providers when needed; strengthening the rules of business conducts of investment firms and; making organizational requirements for investment firms more strict.

This thesis focuses on the quality of (the enforcement of) investor protection afforded by MiFID II and its implementing standards. Therefore only this objective will be further discussed.

1.3.3 *Enhanced investor protection*

The enhancement of investor protection is an important aim of MiFID II – as well as of its predecessors MiFID I and, to a lesser extent, ISD.[37] Even though measures of investor protection were already in place in the first regulatory measures, over time it has become a more and more relevant objective of the regulation of financial markets. Since the regulation of the financial sector has been based on the requirements following the objective of creating a single financial market, it has been an important objective of the regulation to ensure effective market access for financial undertakings which have authorisation from their home country to carry out financial business. The regulation therefore traditionally focused on the mutual recognition of authorisation and home country supervision, and the regulation of the relationship between financial undertakings and its clients has until recently been a subordinate issue.[38]

Nevertheless, as more investors became active over time, the need to regulate this relationship and to offer investors a high level of protection became increasingly relevant.[39] Financial markets have become of great significance for EU economy and society and, therefore, also an essential part of the everyday

[37] Directive 2004/39/EC (MiFID I), recital 2. Also see: Centre for European Policy Studies (CEPS), M. Levin, *Competition, Fragmentation & Transparency Providing the Regulatory Framework for Fair, Efficient and Dynamic European Securities Markets: Assessing the ISD Review* (CEPS Report No. 46, 2003), para 5.2.6.

[38] C. Hørby Jensen and N. Dietz Legind, 'Implementation of European Regulation of the Financial Sector: Consequences for the Consumer Protection' in J. Jemielniak and P. Mikłaszewicz, *Interpretation of Law in the Global World: From Particularism to a Universal Approach* (Springer 2010); N. Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?' 13 European Business Organization Law Review 169; N. Moloney, 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?' 13 European Business Organization Law Review 169; V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law 229.

[39] Directive 2004/39/EC (MiFID I), recital 2.

life of EU citizens.[40] Likewise, it became necessary to provide for clear and harmonized rules to protect EU citizens in their capacity of (retail) investors. This was all the more so as the increased investor activity was coupled with an extension of the range of activities performed by investment firms and the increasingly aggressive selling techniques employed by them,[41] giving rise to deeper conflicts of interests and enforced agency problems.[42]

So, while EU regulation initially concentrated mainly on regulating the wholesale financial market,[43] over time the focus shifted considerably towards the integration of retail consumer financial markets.[44] A high level of 'consumer' protection and trust is nowadays a general theme in the regulation of the relationship between financial undertakings and their clients. The idea behind this is that consumers (i.e. retail clients) have normally more need of protection than professional clients. There are two main reasons for this: (i) investors are not always able to read, absorb or correctly process the available information, and (ii) financial intermediaries (such as investment firms) do not always act in the best interest of the client.[45]

With regard to the first reason, it must be clear that the provision of information, in order to enable investment to make rational investment decisions, is a very important aspect, perhaps even the foundation, of EU investor protection legislation.[46] The focus on provision of information is based on the assumption that information asymmetry is a market failure causing suboptimal investment decisions, and mandatory disclosure of information would take away the information asymmetry and enable investors to take rational decisions.[47] In practice, however, it seen that investors are not always

[40] O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403.

[41] N. Moloney. 'Building a Retail Investment Culture through Law: the 2004 Markets in Financial Instruments Directive' (2005) 6 European Business Organization Law Review 341, p. 368.

[42] Agency problems are generated as firms engage in a wider range of activities and conflicts arise between investor interests, firm own-account positions and the pressure to retain clients, particularly in the execution context. See amongst many others: P. Mahoney, 'Is There a Cure for Excessive Trading' (1995) 81 Virginia Law Review 713, p. 715-717.

[43] Financial Service Action Plan (FSAP) for the years 1999-2005. European Commission, 'Communication from the Commission Implementing the framework for financial markets: action plan' COM (1999) 232 final.

[44] See *inter alia*: European Commission, 'White Paper on Financial Services 2005–2010' COM (2005) 629 final; European Commission, 'Green Paper on Retail Financial Services' COM (2007) 226 final; European Commission, 'Initiatives in the Area of Retail Financial Services: Accompanying Document to the Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions' COM (2007) 724 final.

[45] V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law 229, p. 242.

[46] Ibid., p. 271.

[47] Ibid., referring to: L. Enriques and S. Gilotta, 'Disclosure and Financial Market Regulation' in N. Moloney, E. Ferran and J. Paige, The Oxford Handbook of Financial Regulation (OUP 2015 E. Avgouleas, 'The Global Financial Crisis and the Disclosure Paradigm' (2009) 6 European Company and Financial Law Review 373, p. 440. Also see: F.M.A. 't Hart and C.E. Du Perron, De geïnformeerde consument: Is informatieverstrekking een effectief middel om consumenten afgewogen financiële beslissingen te laten nemen? (Preadvies voor de Vereniging voor Effectenrecht) (Kluwer 2006); H. Beales, R. Craswell and S. Salop, 'The efficient regulation of consumer information' (1981) Journal of Law and Economics 513; S. Grundmann, W. Kerber and S. Weatherill, 'Party Autonomy and the Role of Information in the Internal Market – An Overview' in Party Autonomy and

able to absorb and appreciate the information.[48] Especially in the context of the financial crisis, many cases of mis-selling were experienced, *inter alia* due to the complexity of the products.

With regard to the second reason, it must be held in mind that intermediaries have a crucial role in the financial markets. Investors, especially retail investors, typically approach the financial markets via an intermediary, either because they have no other option (for example because they have no direct access to the venue where the instrument is traded), or because they want the help form a professional party in making an investment decision (usually in the form of investment advice or portfolio management).[49] Intermediaries thus have an influential role. This can pose threats from an investor perspective.[50] The interests of an intermediary can be different than those of its clients. So can intermediaries be tempted to advise, distribute or buy (on behalf of their clients) products which are not necessarily the best for their client, but that are potentially more favourable for the intermediary. Legislation aims to protect investors in such situations.

The primary goal of this legislation is thus to protect the individual interest of investors. Nevertheless, the trust of investors in the investment firm is not only important on the micro level of the individual relationship between investment firms and their clients. Their trust is also essential for the adequate functioning of the financial system on the macro level of society as a whole.[51] When society does not trust the financial system, financing breaks down and investment stops.[52] This is what happened in the

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the Role of Information in the Internal Market, (de Gruyter 2001) p. 3: "*And part of this presumption is, second, that information rules have to be preferred to mandatory rules prescribing substance whenever meaningful information of the client is possible. Information rules, even if mandatory, diverge fundamentally form traditional mandatory rules that fix the content of the contract (…) They are designed to enable party autonomy, they do not restrict the variety of products and contractual conditions that are available*"; G. Hadfield, R. Howse, M.J. Trebilcock, 'Information-Based Principles for Rethinking Consumer Protection Policy' (1998) Journal of Consumer Policy at 152. In the context of securities regulation also: D. Llewellyn, 'The Economic Rationale for Financial Regulation' (FSA Occasional Paper OP01, April 1999) http://www.fsa.gov.uk/pubs/occpapers/OP01.pdf at 21; V. Mak, 'The Myth of the 'Empowered Consumer' - Lessons from Financial Literacy Studies' (2012) 4 Journal of European Consumer and Market Law at 254-255.

[48] See amongst many others: V. Mak and J. Braspenning, 'Errare humanum est: Financial Literacy in European Consumer Credit Law' (2012) 35 Journal of Consumer Policy 307; R.A. Epstein, 'Behavioural Economics: Human Errors and Market Corrections' (2005) 73 University of Chicago Law Review, 111; R.A. Epstein, 'The Neoclassical Economics of Consumer Contracts' (2007) 92 Minnesota Law Review 803; Decision Technology Ltd, N. Vhater, S. Huck and R. Inderst, *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective* (Final Report 2010).

[49] V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law, p. 240.

[50] This is a classical principal-agent problem. See for example: S. Grundmann, W. Kerber and S. Weatherhill, 'Information Intermediaries and Party Autonomy: The Example of Securities and Insurance Markets' in *Party Autonomy and the Role of Information in the Internal Market* (De Grutyer 2001), p. 271; L. Enriques, 'Conflicts of Interest in Investment Services' in G. Ferrarini and E.O. Wymeersch, *Investor Protection in Europe, Corporate Law Making, the MiFID and Beyond* (OUP 2006).

[51] NTBR 2010, 11 De bijzondere zorgplicht van de bank in het spanningsveld tussen het publiek- en privaatrecht O.O. Cherednychenko, p. 4.

[52] N. Moloney, 'Designing a retail investor protection regime I. Why intervene in the retail markets? Encouraging the empowered investor, shielding the irrational investor or supporting the trusting investor?' in How to Protect Investors: Lessons from the EC and the UK (Cambridge University Press, 2010), p. 84-85. Referring to: P. Sapienza and L. Zingales, 'A trust crisis' (2012) 2 International Review of Finance 123.

recent financial crisis. By securing investor trust in the financial system, investor protection regulation thus also serves the public interest.

1.4 MiFID II: Framework for investor protection

1.4.1 *Conduct of business rules as the basis for investor protection*

Currently, there exists an extensive framework for investor protection, ranging from product information requirements to service quality requirements (conduct of business rules) to product regulation.[53] The focus of this thesis is on the second type of investor protection: the conduct of business rules, which are governing the provision of investment services to clients at the pre-contractual and contractual stages. These conduct of business rules have the dual aim of ensuing a high level of investor protection on the one hand and the integrity and overall efficiency of the financial system on the other hand.

For a large part, the MiFID conduct of business rules build upon the broadly formulated principles laid down by the ISD: the loyalty principle – any investment service provider must act honestly, fairly and professionally in the best interests of its clients-, the informed consent principle – the investment service provider must adequately disclose relevant material information when dealing with its clients-, and the know-your-customer principle – the investment service provider must seek from its clients information regarding their financial situation, investment experience and objectives as regards the services requested.[54] These principles are nowadays embedded in MiFID II and its implementing standards and apply to all investment firms, credit institutions and UCITS management firms when providing investment services or ancillary services.

1.4.2 *Overarching principles*

The three overarching principles to act honestly, fairly and professionally in accordance with the best interest of its clients (loyalty),[55] to give information which is fair, clear and not misleading (informed consent),[56] and to provide services that take account of the individual circumstances of the client (know-your-customer),[57] remain the basis of the conduct of business rules under MiFID II.[58] The loyalty duty protects clients when they are dealing with firms that, given their professionality, are in a stronger

53 *Nota bene*, Colaert distinguishes these three building blocks of investor protection: (i) product information requirements; (ii) services quality requirements (conduct of business rules); and (iii) product regulation. See: V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law 229,

54 European Commission, 'Communication on the Application of Conduct of Business Rules under Article 11 of the Investment Services Directive' COM (2000) 722 final.

55 Article 24(1) MiFID II.

56 Article 24(3) MiFID II.

57 Article 25(2) MiFID II.

58 Committee of European Securities Regulators (CESR), *A consumer's guide to MiFID: Investing in financial products* (CESR/08-003), p. 5.

position. This duty serves both as an umbrella clause, overarching the more detailed conduct of business rules, and a catch-all provision, ensuring that conduct which is not regulated by the more specific conduct of business rules is still covered by this general fiduciary duty.[59] The informed consent principle helps clients understand products and services so that they are able to make an informed decision and that they do not receive biased or confusing information. The know-your-customer principle ensure that investment firms provide their clients with services that take account of their individual circumstances, so that their investments corresponds to their investor profile and requests. These three principles apply during the different stages of the investment process. The broad principles are supplemented and elaborated in the more specific conduct of business rules.

1.4.3 *Information and disclosure obligations*

A large part of the more specific conduct of business rules consists of information and disclosure obligations. Given their imperative function and position in the financial market, investment firms play an important role as "information intermediaries".[60] They must channel appropriate (product) information to the client, so as to enable him to make an informed decision. Different information duties are therefore imposed on investment firms.

Generally, investment firms are required to provide clients in good time before the provision of investment services or ancillary services to clients with a general description of the nature and risks of financial instruments. The description of the instrument must at least explain the nature of the specific type of instrument concerned, the functioning and performance of the financial instrument in different market conditions and the risks particular to that specific type of instrument in sufficient detail to enable the client to take investment decisions on an informed basis.[61] Notably, when a product information document is or should be available (for example in case of PRIIPs or UCITS),[62] investment firms are obliged to provide this information document in good time before the retail investor is bound by any

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[59] V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law, p. 242.

[60] V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law, p. 240-242. Also see: S. Grundmann, W. Kerber and S. Weatherhill, 'Information Intermediaries and Party Autonomy: The Example of Securities and Insurance Markets' in *Party Autonomy and the Role of Information in the Internal Market* (De Grutyer 2001).

[61] Article 48 of Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU 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 (MiFID II Delegated Regulation)

[62] Article 13 of 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); Article 80(2) of 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) as regards depositary functions, remuneration policies and sanctions (UCITS Directive)

contract or offer relating to that product or service[63] or they must inform the client where the information is made available to the public (for example in case of a prospectus for transferable securities).[64]

Next to that, investment firms have certain reporting obligations. Pre-contractually, investment firms have to provide clients with information on (i) the investment firm and its services (ii) on the risks and financial instruments and proposed investment strategies (iii) costs and charges related to products and services, and (iv) execution venues.[65] Investment firms can also have post-contractual reporting obligations.[66]

Lastly, the conduct of business rules feature disclosure requirements for investment firms concerning (potential) conflicts of interest. Whenever organisational or administrative arrangements of the investment firm in order to prevent or manage conflict of interest are not sufficient to ensure that risks of damage to a client's interest will be prevented, the investment firm has to disclose the nature and source of the conflict of interest and the steps taken to mitigate those risks, before undertaking business on its behalf.[67] With respect to all those information obligations, information quality requirements apply; at the least, the information must be fair, clear and not-misleading.[68]

1.4.4 *Due diligence: suitability and appropriateness*

In certain circumstances the investment firm will have to process the product information for the benefit of the investor in order to ensure that the products and services in which the client would invest, suit his investment profile. When providing investment advice or portfolio management, the investment firm must make sure that it recommends the client investment services and financial instruments that are suitable for him and, in particular, are in accordance with his risk tolerance and ability to bear losses (the suitability test).[69] When providing other investment services than investment advice or portfolio management, the investment firm must assess whether the investment service or product envisaged is appropriate for the client (the appropriateness test).[70] If the service or product is not considered appropriate, or when there is not enough information available to make the assessment, the firm is required to warn the client.[71] There are however certain identified circumstances in which the appropriateness test is not required (so called execution-only services).[72] The execution-only regime only applies when the investment service relates to non-complex financial instruments, the service is

[63] Article 46 MiFID II Delegated Regulation.
[64] Art. 48 (3) MiFID II Delegated Regulation. Article 14(7) of Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC (Prospectus Directive).
[65] Article 24 (4) MiFID II
[66] Article 25(6) MiFID II
[67] Article 23(2) MiFID II
[68] Article 24(3) MiFID II
[69] Suitability test: Article 25(2) MiFID II.
[70] Appropriateness test: Article 25(3) MiFID II.
[71] Article 25(3) MiFID II.
[72] Article 25(4) MiFID II.

provided at the initiative of the client, the client has been clearly informed that for this service the investment firm is not required to carry out a suitability assessment and therefore he does not benefit from the corresponding protection offered by the conduct of business rules and the investment firm is in compliance with his obligations regarding conflicts of interests (see below).[73]

1.4.5 *Other service quality measures*

Besides the information and due diligence duties, there are other categories of quality measures. These measures aim to improve the quality of services provided by an investment firm to its clients. Where the information duties aim to ensure that the investment firm, as an information intermediary, provide the client with adequate information so that the client is able to make an informed decision regarding a financial instrument, other service quality rules see to it that investment firms act in the best interest of the client.[74]

The first rule is the know-your-customer rule, which is connected to the suitability and appropriateness assessment and provides that investment firm must obtain adequate information about its clients' (investment objectives, financial situation and)[75] knowledge and experience.[76] The information must be sufficient to enable the investment firm to make an assessment of the suitability and/or the appropriateness of a specific type of service or product for the client.[77] The information that needs to be obtained by the investment firm in order to be able to carry out such assessment includes information regarding the client's financial situation,[78] his investment objectives[79] and his knowledge in the investment field.[80]

The second measure is the best execution requirement, which obliges investment firms to take all sufficient steps to consistently execute client orders on terms that are most favourable to the client and to obtain the best possible result for the client.[81] For the purposes of determining the best execution when executing clients' order, investment firms have to take account of factors such as price, costs,

[73] Article 25(4) MiFID II
[74] V. Colaert, 'Building blocks of investor protection: All-embracing regulation tightens its grip' (2017) 6 Journal of European Consumer and Market Law, p. 257.
[75] With regard to the suitability test. For the appropriateness test only the client's knowledge and experience will be assessed.
[76] Article 25(2) MiFID II.
[77] As specified by Article 54(2) of MiFID II Delegated Regulation the investment firm needs to obtain form clients such information as is necessary "*to understand the essential facts about the client and to have a reasonable basis for determining, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria: (a) it meets the investment objectives of the client in question, including client's risk tolerance; (b) it is such that the client is able financially to bear any related investment risks consistent with his investment objectives; (c) it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.*"
[78] Article 54(5) MiFID II Delegated Regulation.
[79] Article 54(5) MiFID II Delegated Regulation.
[80] Article 55 MiFID II Delegated Regulation.
[81] Article 27 MiFID II.

speed, likelihood of execution and settlement, size, nature or any other consideration relevant of the execution of the order.[82]

The third measure, one of the most controversial rules to avoid investment firms pursuing their own interest rather than the best interest of their clients, is a ban on inducements in relation to investment advice or portfolio management, prohibiting that an investment firm would grant or obtain a fee or non-monetary benefit to or from a third party in relation to the service to a client.[83] This last measure, the ban on inducements, is part of the bigger conflict of interest regime, which requires investment firms, in a view to ensure that such conflicts of interest do not adversely affect the interests of their clients, to take all appropriate steps to identify and prevent or manage conflicts of interest and mitigate the potential impact of those risks as far as possible.[84]

1.4.6 *Client categorisation*

The extent to which the conduct of business rules are applicable in a relation between the investment firm and the client depends on the nature of the client. Under MiFID clients are classified in three categories: retail clients, professional clients and eligible counterparties.[85] Generally, professional clients are clients that possess the experience, knowledge and expertise to make its own investment decisions and properly assess the risk that accompany all investment services, activities and financial instruments.[86] They can be entities that are required to be authorized or regulated to operate in the financial markets, large undertakings (that meet certain size requirements), national or regional governments or other institutional investors.[87] Eligible counterparties are entities, such as investment firms, credit institutions or pension funds, that are authorized or regulated to operate in the financial markets and that are not given investment advice, but to which a credit institution or an investment firm provides the services of reception and transmission of orders on behalf of clients or execution of such orders or dealing on own account. They are considered to be the most sophisticated investors or financial market participants and are therefore offered the least protection under the conduct of business rules. Retail clients are all clients that do not fall under the categories of professional clients or eligible counterparties. In principle, retail clients are protected by the full scope of the business conduct rules. However, retail clients may request to be treated as professional clients, and thus waive some of the

[82] Article 27 MiFID II.
[83] Article 33 MiFID II Delegated Regulation. Fees, commissions, monetary or non-monetary benefits received by the firm providing investment research from any third party should only be acceptable when they are provided in accordance with requirements specified in Article 24(9) of Directive 2014/65/EU and Article 13 of Commission Delegated Directive (EU) 2017/593.
[84] Article 23 MiFID II.
[85] The MiFID Delegated Regulation and Annex II to MiFID II provide further clarity as to what rules are applicable to each client category.
[86] Article 35(2) and 36 MiFID II Delegated Directive.
[87] Annex II to MIFID II.

protections afforded to them by the conduct of business rules, provided that they meet certain requirements concerning their expertise, experience and knowledge in the investment field.[88]

1.5 Experience in the financial crisis: Regulatory issues

As we have seen in the previous paragraph, there is an extensive framework of rules that are aimed to make sure that the investor is well-informed about financial instruments and their accompanying risks and that investment firms act in the best interest of their clients. We have also seen that these rules are already in place for decades (the conduct of business principles were already embedded in MiFID I and ISD). Nevertheless, experience in the years preceding the MiFID II framework, especially experience in the financial crisis, shows that despite these rules there were still many cases of mis-selling with damages, even in individual cases, running into millions of euros.[89] How was this possible?

Finding the cause for mis-selling is very difficult, because many factors play a role. Nevertheless, some common issues were encountered as regards investor protection, mostly relating to uncertainty around execution-only services, quality of investment advice, inducements, categorisation of clients and best execution. These issues were addressed by the European Commission in their Impact Assessment[90] and their Proposal for a new Directive and Regulation on markets in financial instruments.[91]

The first issue related to the uncertainty around execution-only services, in particular to the range of instruments and services which were covered under the execution-only regime. As explained in paragraph 1.4.3, execution-only services encompass services by investment firms that provide investors with a means to buy and sell non-complex financial instruments in the market, without undergoing any assessment of the appropriateness of the given product. Even though individual investors greatly value the possibility to buy and sell such non-complex products based on their own assessment and understanding,[92] problems for investors are more likely to occur. When there is no assessment of the

[88] According to Annex II of MiFID II, a retail investor can waive certain protections afforded by the conduct of business rules if he meets at least two of the following three criteria: (a) the investor has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters; (b) the size of the investor's financial instrument portfolio, defined as including cash deposits and financial instruments exceeds 500,000€; (c) the investor works or has worked in the financial sector for at least 1 year in a professional position, which requires knowledge of the transactions or services envisaged

[89] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 114.

[90] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final.

[91] European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final.

[92] This was underlined by 675 replies received from citizens to the MiFID consultation. Investors across Member States vary in their use of execution-only services, but estimates suggest it can reach up to a third of all retail transactions in some Member States (source: Europe Economics). See: European Commission, Director General Internal Market and Services, *Public consultation: review of the markets in financial instruments directive (MiFID)* (2010). See also: European Commission, 'Impact assessment accompanying the proposals for

suitability or appropriateness of the product, there is a greater risk of mis-selling by investors. The investor may not fully understand the risk related to a product and can therefore be unable to assess whether the product would be right for him. To limit this problem, MiFID reduced the list of instruments that are considered non-complex[93] and added further criteria limiting the possibility to classify a financial instrument as non-complex.[94] Consequently, this extends the scope of financial instruments that are subject to the obligation to assess the client's knowledge and experience in order to determine the appropriateness of the product for investors.

The second problem that was experienced related to the quality of the investment advice. Throughout the EU, investment firms showed weaknesses in their ability to recommend suitable products to investors.[95] One study even showed that in 2007-2011 investment advice was unsuitable roughly half of the time.[96] Also the number of complaints regarding the quality of investment advice were increasing. Annual reports of several financial services-focused Ombudsmen showed the prevalence of mis-selling and bad advice provided to retail clients.[97] Often the complaints related to the inadequacy of the information about and explanation of the risks related to certain products or the pressure to exerted to purchase overly risky assets. One of the drivers for this problem was that under MiFID I intermediaries that are providing investment advice were not expressly required to explain the basis on which they

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a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final.

[93] Article 25(4) MiFID II. Compare with Article 19(6) MiFID I. The range of products that will be considered as non-complex financial instruments is more limited in MiFID II. For example, non-UCITS collective investment schemes are now always considered to be complex, which means that an appropriateness assessment has to be carried out. The same counts for shares that embed a derivative, bonds or other forms of securitised debt or money market instruments that embed a derivative or incorporate a structure that makes it difficult for the client to understand the risk involved, shares or units in structured UCITS, and structured deposits that incorporate a structure that makes it difficult for the client to understand the risk of return or the cost of exiting the product before term.

[94] Article 57 of the MiFID II Delegated Directive. Compare with Article 38 of the MiFID I Delegated Directive. In addition to the criteria that were already recognized in Article 38 of the Delegated Directive 2006/73/EC, Article 57 of the Delegated Directive (EU) 2017/565 now requires that an instrument not included explicitly in Article 25(4)(a) of MiFID II, in order to be considered non-complex, must (i) not incorporate a clause, condition or trigger that could fundamentally alter the nature or risk of the investment or pay out profile, and (ii) not include any explicit or implicit exit charges that have the effect of making the investment illiquid even though technically frequent opportunities to dispose or redeem it would be possible.

[95] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final. Also see: Decision Technology Ltd, N. Vhater, S. Huck and R. Inderst, *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective* (Final Report, 2010). For assessment at national level see *inter alia*: Financial Ombudsman Service (United Kingdom), *Annual Review* (2009 – 2010); Ombudsmann der Privaten Banken (Germany), *Tätigkeitsbericht* (2009); Hellenic Ombudsman for Banking-Investment Services (Greece), *Annual Report* (2009).

[96] European Commission, Directorate-General Health and Consumer Protection, *Consumer attitudes towards cross-border trade and consumer protection* (2012). Also see: Decision Technology Ltd, N. Vhater, S. Huck and R. Inderst, *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective* (Final Report, 2010).

[97] See e.g. Financial Ombudsman Service (United Kingdom), *Annual Review* (2009 – 2010); Ombudsmann der Privaten Banken (Germany), *Tätigkeitsbericht* (2009); Hellenic Ombudsman for Banking-Investment Services (Greece), *Annual Report* (2009).

provide advice (including the range of products they consider and assess).[98] This is now changed. In order to give all relevant information to investors, MiFID II requires investment firms now to clarify the basis of the advice they provide, including the range of products they consider in providing personal recommendations to clients.[99] Particularly, Article 52(3) of the MiFID II Delegated Regulation[100] is relevant, which specifies that "*investment firms shall provide a description of the types of financial instruments considered, the range of financial instruments and providers analysed per each type of instrument according to the scope of the service, and, when providing independent advice, how the service provided satisfies the conditions for the provision of investment advice on an independent basis and the factors taken into consideration in the selection process used by the investment firm to recommend financial instruments, such as risks, costs and complexity of the financial instruments.*"

The third issue concerned the framework for inducement. MiFID I already regulated the payment of various types of incentives to investment firms which can influence the choice and promotion of the products when investment provide services to clients (inducements). MiFID I only allowed such inducements when they were clearly disclosed to the client and when they were designed to enhance the quality of the service to the client (and not impair the firm's duty to act in the best interest of the client).[101] However, these requirements have not always proven to be very clear or well-articulated for investors, and have created some practical difficulties with respect to portfolio management and investment advice.[102] MiFID II strengthens the already existing inducement framework and introduces the concept of 'independent investment advice'.[103] When firms are providing 'independent' investment advice or portfolio management, they are prohibited from receiving and retaining any fees, commission, or (non-)monetary benefit from third parties; these benefits must be fully passed on to clients.[104] The investment firm is also not allowed to off-set any third-party payments from the fees due to the client to the firm. Minor-non monetary benefits are excluded from this prohibition, but they must not impair a firm's duty to act in the best interest of its clients.[105] Firms that are not providing independent

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98 European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 116.

99 MiFID II, recital 72; Article 24(4) MiFID II; Article 52 MiFID II Delegated Regulation.

100 Commission Delegated Regulation (EU) 2017/565 of 25 April 2016 supplementing Directive 2014/65/EU 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 (MiFID II Delegated Regulation).

101 Article 26 (b) of MIFID I Delegated Directive.

102 European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 117, referring to: Committee of European Securities Regulators (CESR), *CESR's Responses to Questions 15-18 and 20-25 of the European Commission Request for Additional Information in Relation to the Review of MiFID* (CESR/10-860), p. 6-8.

103 See Article 24(7) MiFID II.

104 Article 24(7)(b) and Article 24(8) MiFID II. *Nota bene*, Firms providing independent advice or portfolio management should also set up a policy, as part of their organisational requirements, to ensure that third party payments received are allocated and transferred to the clients.

105 For a definition of what qualifies as minor non-monetary benefits, see Article 12(3) MiFID II Delegated Directive.

investment advice or portfolio management must comply with the existing inducement rules from MiFID I for all types of third party payments.[106] In all circumstances the clients need to be accurately, and where relevant periodically, informed about the benefits the investment firm has received in connection with the investment services provided. Where applicable, the investment firm must inform clients on how the fee, commission or (non-)monetary benefit can be transferred to them.[107]

Another problem encountered related to the presumption that professional clients have the necessary level of experience and knowledge. Under Article 71(6) MiFID I investment firms were authorised to consider professional clients[108] as being capable of making their own investment decisions and understanding all risks involved. The rationale being that professional investors (and eligible counterparties)[109] have access to more information, benefit from higher expertise and better able to protect themselves. Nevertheless, the financial crisis showed that in practice many non-retail investors, notably local authorities, municipalities and corporate clients, suffered losses due to being mis-sold complex financial instruments of which they did not fully understand the risks.[110] Further, the provision of services to eligible counterparties was not subject to the general conduct of business principles that these services should be fair and not misleading. MiFID II made only relatively minor changes to the client categorisation definitions. The basic principles, including the presumption that professional investors have the necessary level of experience and knowledge, remained untouched. However, under MiFID II municipalities and local public authorities are now excluded from the list of eligible counterparties and of clients who are considered to be professionals[111] and the obligation is added that investment firms in their relationship with eligible counterparties will have to act honestly, fairly and professionally and that they will have to communicate in a way which is fair, clear and not misleading.[112]

The last problem experienced in relation to the conduct of business rules concerned the rules on execution quality and best execution. Although trading venues already had to provide post-transparency on the prices of executed trades under MiFID I, they were not yet required to publish data on execution quality (including the speed of trade execution and the number of trades cancelled prior to execution).[113] The absence of such data could impair the ability of investment firms to select the best possible venue

[106] Article 24(9) MiFID II.
[107] Recital 74 MiFID II. Article 12(1) MiFID II Delegated Directive.
[108] See Annex II of Directive 2004/39/EC (MiFID I) for the categories of persons that can be identified or treated as professional clients for the purpose of the Directive.
[109] In the MiFID framework, clients were classified in three categories: retail clients, professional clients and eligible counterparties. For definitions and further details, see Annex II of Directive 2004/39/EC (MiFID I).
[110] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 17.
[111] Recital 104 MiFID II; Annex II MiFID II.
[112] Article 30(1) MiFID II.
[113] Committee of European Securities Regulators (CESR), *Technical Advice to the European Commission in the context of the MiFID review – Investor protection and Intermediaries* (CESR/10-859), p. 18; Price Waterhouse Coopers (PWC) *Data gathering and analysis in the context of the MiFID Review*, prepared for the European Commission (2010), p. 363.

for executing a trade for a client, therefore MiFID II now imposed new requirements on firms and trading venues to produce public data about (the quality of) executed transactions.[114] Investment firms must now annually publish the top five execution venues where they executed client orders in the preceding year for each class of financial instruments, as well as information on the quality of execution obtained. Trading venues must also annually publish information on quality of execution for certain types of financial instruments.

[114] See Article 27 MiFID II

CHAPTER 2: Supervision, Enforcement and Compensation

2.1 Introduction

As seen in the previous chapter, the conduct of business rules provide a coherent framework for the protection of retail investors. Several information duties are imposed on investment firms with the idea to alleviate the information asymmetry and to enable clients to make an informed decision – the provision of information would to lead to better expectation management.[115] There is an active duty on investment firms to know their clients' (financial situation and investment objectives)[116] experience and knowledge in the investment field and to assess this information when providing services to clients – so as to avoid instances of mis-sellings, where clients end up with products or services that are unsuitable or inappropriate for them. Also, there are additional measures in place, such as best-execution and rules on conflict of interest, that protect investors from ending up with products or services that are not in their best interest. There is thus an extensive, harmonized framework of prudential rules and rules of conduct for investment firms which should ensure safety, stability and integrity of financial markets and adequate protection for investors.

The previous chapter also demonstrated that the financial crisis proved that investors are not always benefiting from sufficient or appropriate levels of protection.[117] The consequence of which is that investors may be mis-sold financial products which are not appropriate for them or may make investment choices which are not optimal. The amount of damage that investors in these cases can incur is tremendous. In the process of MiFID review, the Commission addressed the technical issues that resulted in regulatory loopholes in the framework for investor protection. Nevertheless, the regulatory issues relating to the conduct of business rules are not the only explanation for the lack of appropriate investor protection experienced in the crisis. A lot of the protection deficiencies were caused or influenced by supervisory failures, mainly lack of cooperation, lack of sanctioning powers and lack of enforcement. Certain changes have been made to overcome these issues, however, as will be discussed in this chapter, problems still persist.

2.2 Supervision and enforcement

The overhaul of the conduct of business rules in MiFID II was aimed at improving investor protection and empowering investors to exercise their rights. However, investors cannot benefit from this (additional) protection, when the application of the rules in practice cannot be guaranteed. Effective

[115] J. Hofstra, 'Geschiktheid en passendheid onder MiFID II: Interview met Ronald Janssen, Arthur Kilian en Tom Loonen' (2016) 6 Tijdschrift voor Compliance 373.
[116] When carrying out investment advice or portfolio management.
[117] See inter alia European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 15-17

supervision and enforcement of the rules is crucial to the functioning of the financial system, as this will ensure sound and stable financial markets and, ultimately, the protection of investors. Lack of supervision or enforcement in one Member State may have significant implications for the stability and functioning of the whole financial system. Due to the European passport, supervisory failure in one Member State directly impacts other Member States as well. It is therefore essential to ensure a consistent and effective application of the MiFID rules in all Member States.[118]

2.2.1 *The home Member State system*

EU investor protection relies for a large part on a public supervision and enforcement model. The extensive framework of financial market rules are supervised and enforced by financial market regulators, including (to a limited extent) ESMA at the European level. Most day-to-day supervision is conducted by competent authorities at national level (NCAs), operating under a home Member State control model where the domestic supervisors supervise the pan-EU activities of the investment firms which have their registered offices in that Member State. This system is largely based on mutual trust between Member States. Each Member State must be satisfied that the other Member States have in place supervision powers and regulations that are efficient and adequate and are thus capable of protecting all investors within the EU. This mutual trust is supported by a certain level of harmonization of supervisory powers, including investigatory powers and powers to impose remedies.[119] It is also strengthened by cooperation and information exchange obligations. For example, under Article 79 MiFID II NCAs are obliged to cooperate with each other where necessary for the purpose of carrying out their duties under MiFID II or MiFIR or where making use of their powers set out in MiFID II or in national law. This Article also obliges NCAs to render assistance to other NCAs, to exchange information and to cooperate in any investigation or supervisory activities.

Some of these cooperation requirements already existed under MiFID I. Nevertheless, the financial crisis demonstrated that even with these requirements mutual trust could not be automatically assumed. The home state control model turned out to have weaknesses and was not able to always guarantee correct application of European rules.[120] Various reports, including the De Larosière report,[121] highlighted that fragmented supervision and the home state control system, relying solely on national supervision, was not "fit for purpose" in an increasingly internationalised market.

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[118] European Commission, 'Communication on "Reinforcing sanctioning regimes in the financial services sector' COM(2010) 716 final , p. 2.
[119] See Article 69, 70 and 72 MiFID II
[120] A. van Loon, 'Domestic politics and national differences in restructuring EU financial supervision' (2018) 19 European Politics and Society 252; P. Schrammo, 'EU Day-to-Day Supervision or Intervention-based Supervision: Which Way Forward for the European System of Financial Supervision?' (2012) 32 Oxford Journal of Legal Studies 771, 774-775; G. Tsagas, 'The Regulatory Powers of the European Supervisory Authorities: Constitutional, Political and Functional Considerations' in G. Deipenbrock and M. Andenas, *Regulating and Supervising European Financial Markets. Risks and Achievements* (Springer, 2016), p. 111.
[121] The High-level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, *Report* (2009).

2.2.2 *Experience in the financial crisis: supervisory and enforcement issues*

The De Larosière report identified a series of weaknesses in the former EU system of financial supervision and regulation. Specifically, it identified: (1) a lack of adequate macro-prudential supervision, (2) ineffective early warning mechanisms, (3) problems of competences, (4) failures to challenge practices on a cross-border basis, (5) lack of frankness and cooperation between supervisors, (6) a lack of consistent supervisory powers across Member States, (7) a lack of resources in the level 3 committees,[122] and (8) no means for supervisors to take common decisions.[123] It demonstrated the need for a more robust financial supervision and enforcement system.

The De Larosiere Report highlighted that although there were many causes for the financial crisis, and the way in which the financial sector has been supervised has not been the primary cause (with regard to the regulatory issues, see paragraph 1.5 of this thesis), there still have been real and important supervisory failures, both from a macro and micro-prudential standpoint.

Firstly, the crisis has demonstrated a lack of adequate macro-prudential supervision. Financial supervisors had placed too much emphasis on the supervision of individual firms, and too little on the macro-prudential developments. The De Larosière Group believed that there should be wider macro-economic oversight which takes account of global issues. This oversight should be at the level of the individual Member States as well as at EU level. The Group proposed that an EU institution should be entrusted with this task.[124]

Secondly, the De Larosière Group noticed that the early warning mechanisms were ineffective. It identified a shortage of comments about worrying developments in macroeconomic imbalance's and lowering price of risk. There was no mechanism to ensure that the assessment of risk was translated into action. The Group proposed that there should be an effective and enforceable mechanism to check that the risks identified by the macro-prudential analysis have resulted in specific action by the new European Authorities and national supervisors.

Thirdly, the De Larosière identified problems relating to the competences of (national) supervisors. During the crisis there have been a significant number of instances of failure in the supervision of particular institutions. Although the De Larosière Group believed that no system can avoid errors of judgment occurring, some errors could be prevented when the supervisors are well-staffed, experienced

[122] The level 3 committees at that time were comprised of the Committee of European Banking Supervisors (CEBS), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and the Committee of European Securities Regulators (CESR).
[123] The High-level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, *Report* (2009), p. 39-42.
[124] This analysis resulted in the creation of the European Systemic Risk Board (ESRB), that is now entrusted with the task of macro-prudential oversight. See para 2.2.3.

and well-trained. They also stressed that there is an advantage in analysing and publishing the circumstances of those failures, so that lessons can be learnt and future supervisory behaviour improved.

Fourthly, there were failures to challenge supervisory practices on a cross-border basis. In the home Member State system there is extensive reliance on the judgments and decisions of the home supervisors. When investment firms spread their activities into other countries, it can create significant risks in those other countries. Yet the ability of the supervisors in those host countries to challenge the decisions of the home regulator do not sufficiently recognise these risks. The De Larosière Group therefore proposed effective means of challenging the decision of the home regulator, either through more speedy and effective arrangements for peer review and to require binding mediation mechanisms for cross-border supervisory problems (when the home Member State does not meet the necessary supervisory standards).

Fifthly, there was a lack of frankness and cooperation between supervisors.[125] The De Larosiere group reported that "*as the crisis developed, in too many instances supervisors in Member States were not prepared to discuss with appropriate frankness and at an early stage the vulnerabilities of financial institutions which they supervised*".[126] The information flow was defective and this led to an erosion of the mutual trust among supervisors. The Group therefore set out some proposals to improve the frank exchange of information.

Sixthly, the De Larosière Report encountered a lack of consistent supervisory powers across Member States. There were substantial differences in the powers granted to national supervisors in different Member States, both in respect to supervisory powers and enforcement actions (including sanctions) available to them under national law. This lack of consistency was also extensively discussed by the Commission in its Communication on Reinforcing the sanctioning regimes in the financial sector[127] and the accompanying Impact Assessment,[128] as well as in its MiFID Impact Assessment.[129] Review[130]

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[125] On this point also see European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 113-114.
[126] The High-level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, *Report* (2009), paragraph 159.
[127] European Commission, 'Communication on "Reinforcing sanctioning regimes in the financial services sector' COM(2010) 716 final.
[128] European Commission, 'Impact Assessment accompanying the document on reinforcing sanctioning regimes in the financial services sector' COM(2010) 716 final.
[129] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final.
[130] Committee of European Banking Supervisors (CEBS), *Mapping of supervisory objectives, including early intervention measures and sanctioning powers* (CEBS/2009-47); Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), *Report to the European Commission on EU supervisory powers, objectives, sanctioning powers and regimes* (CEOPS/21-09); Committee of European Securities Regulators (CESR), *Report on CESR members' powers under the Prospectus Directive and its implementing measures* (CESR/07-384); Committee of European Securities Regulators (CESR), *Report on administrative measures and sanctions as well as criminal sanctions available in Member States under the Market Abuse Directive* (CESR/07-693); Committee of European Securities Regulators (CESR), *Report on the mapping of supervisory*

showed that there were strong divergences across Member States (stemming from different factors such as the differences in national legal systems, constitutional requirements, the functioning of national administrations and the role of courts) and that in several areas supervisors were lacking the necessary information or powers to properly fulfil their role.[131] Divergences related to the type,[132] nature[133] and level[134] of sanctions available, the type of persons who could be sanctioned[135] and the level of application of sanctions.[136] The way that supervision took place and sanctions were applied in some Member States raised serious questions as to their effectiveness, proportionality and dissuasiveness. The De Larosière Group therefore proposed that extensive review and (further) harmonization of the powers and actions available to them should be effectuated, in order to bring all supervisors to a high level minimum standard.

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powers, supervisory practices, administrative and criminal sanctioning regimes of MS in relation to the MiFID Directive (CESR/08-220).

[131] European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM (2011) 656 final, p. 13, 107-115. *Nota bene,* The Commission stressed that the way the sanctions were designed in some Member State raised questions as to the effectiveness, proportionality and dissuasiveness of their sanctioning regime. And the divergences in the (way of) enforcement between Member State were considered a sign of weakness of EU financial markets, as they may create distortions of competition in the Internal Market, and as they would allow financial institutions to exploit the differences between the legislation in different Member States.

[132] For instance, the CESR Report showed that 5 Member States did not provide authorities the possibility to give public reprimands and warnings and 7 Member States did not provide for the publication of sanctions. Even though, research shows that publication of sanctions can contribute to general prevention as they serve as reminders of the sanctions applicable to certain types of sanctions and they show that there is a real risk for that behaviour being discovered and punished by the authorities. Committee of European Securities Regulators (CESR), *Report on the mapping of supervisory powers, supervisory practices, administrative and criminal sanctioning regimes of MS in relation to the MiFID Directive* (CESR/08-220), p. 14-15; P. Granlund, *Regulatory choices in global financial markets: restoring the role of aggregate utility in the shaping of market supervision* (Bank of Finland Research Discussion Papers 2008/1), p. 19.

[133] For instance, the CESR Report showed that only 13 Member States provided for criminal sanctions, including criminal fines and/or custodial penalties. The type of infringements for which criminal sanctions were available also strongly differed from state to state. Committee of European Securities Regulators (CESR), *Report on the mapping of supervisory powers, supervisory practices, administrative and criminal sanctioning regimes of MS in relation to the MiFID Directive* (CESR/08-220). And in particular the Summary table showing Members' ability to impose administrative measures and criminal sanctions in relation to all MiFID provisions on p. 20-21.

[134] For instance, the 2009 CESR report showed that the maximum amount of administrative fines for MiFID violations ranged from €12.500 (in Luxembourg) to €5,352,990 (in Sweden). For criminal fines the range also varied strongly from €5,000 (in Bulgaria) to €16,129,032 (in Estonia). Committee of European Securities Regulators (CESR), *Report on the mapping of supervisory powers, supervisory practices, administrative and criminal sanctioning regimes of MS in relation to the MiFID Directive* (CESR/08-220).

[135] In some Member States (criminal) sanctions are not applicable to natural persons, in other Member States they are not applicable to legal persons. Competent authorities would however be better able to choose the sanction that is optimal in terms of effectiveness, proportionality and dissuasiveness if they can apply sanctions to both natural and legal persons. See: P. Granlund, *Regulatory choices in global financial markets: restoring the role of aggregate utility in the shaping of market supervision* (Bank of Finland Research Discussion Papers 2008/1), p. 19.

[136] The CEBS report and the CEIOPS report show that the number of sanctions applied in different Member States in 2007 ranged from 0 to over 100. It also showed that some Member States had not applied any sanction for more than two years. Committee of European Banking Supervisors (CEBS), *Mapping of supervisory objectives, including early intervention measures and sanctioning powers* (CEBS/2009-47), p. 55; Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), *Report to the European Commission on EU supervisory powers, objectives, sanctioning powers and regimes* (CEOPS/21-09), p. 26, 127.

Seventhly, there was also a lack of resources in the level 3 committees.[137] The resources available to the level 3 committees were severely insufficient for the heavy workload required of them in implementing the Financial Services Action Plan. The De Larosière Group therefore proposed that the powers and resources available to them would be extended.

Lastly, it was considered problematic that supervisors did not have the means to take common decisions. The level 3 committees were unable to contribute to effective crisis management for several reasons, most importantly because of their inability to take urgent decisions. As a consequence, they failed to develop the procedures necessary to respond rapidly to the (emerging) crisis. Evidence found by the De Larosiere Group clearly showed that "*the crisis prevention function of supervisors in the EU has not been performed well, and is not fit for purpose*".[138] They therefore proposed to introduce a new structure to make (national and) European supervision more effective and to improve financial stability.

2.2.3 *The updated financial supervision and enforcement system*

Following the recommendations of the De Larosière report, the Commission proposed a new financial architecture which distinguishes between micro- and macro-prudential supervision. The European System of Financial Supervision (ESFS) was introduced, which consists of the European Systemic Risk Board (ESRB), three European Supervisory Authorities (ESAs) – namely the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)– and the national supervisors. The objective of the EFSF is to ensure that the rules applicable to the financial sector are adequately implemented across Member States with the purpose of preserving financial stability, promoting confidence and providing investor protection. The objective is also to develop a common supervisory culture and to facilitate a single financial market.[139] The EFSF is a system of micro- and macro-prudential supervision. On the one side, there are EBA, ESMA and EIOPA that perform micro-prudential oversight, the objective of which is to safeguard financial soundness at the level of individual financial institutions and to protect consumers of financial services. On the other side, there is the ESRB, being responsible for identifying and assessing potential threats to the financial stability arising from macro-economic developments and developments within the financial system as a whole, thus focusing on macro-prudential supervision.[140]

The institution concerning capital markets, and thus related to the supervision and enforcement of MiFID, is ESMA. ESMA replaced its predecessor the Committee of European Securities Regulators

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[137] i.e. the Committee of European Securities Regulators (CSER), the Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), and the Committee of European Banking Supervisors (CEBS)
[138] The High-level Group on Financial Supervision in the EU, chaired by Jacques de Larosière, *Report* (2009), paragraph 164.
[139] Factsheet on the European System of Financial Supervision (EFSF), retrieved from: http://www.europarl.europa.eu/ftu/pdf/en/FTU_2.6.14.pdf, accessed 9 April 2009.
[140] A. van Loon, 'Domestic politics and national differences in restructuring EU financial supervision' (2018) 19 European Politics and Society 252.

(CESR), which only had advisory powers and could only issue non-binding guidelines and recommendations. The structure of ESMA is essentially the same, but in addition it has increased responsibilities, defined legal powers and greater authority.[141]

The new powers of ESMA show that the European enforcement architecture has been changing over the last years. However, the slogan "central regulation, local supervision"[142] is, for the time being, still valid.[143] National supervisors still maintain the actual powers concerning day-to-day supervision and enforcement, with ESMA pushing for a common supervisory culture and consistent supervisory practices.[144]

With regard to sanctioning, there is less harmonization, reflecting Member States' control.[145] MiFID II does however require Members States to provide for sanctions and measures which are effective, proportionate and dissuasive.[146] Administrative sanctions and measures set out by Member States should also satisfy certain requirements in relation to addressees, criteria to be taken into account when applying a sanction or measure, publication, key powers to impose sanctions and levels of administrative fines.[147]

2.2.4 *Effective enforcement under the updated system?*

The updated supervisory and enforcement system, transferring some of the Member States' competence and discretion in regulation national institutions to a European system, is subject to a lot of discussion and critique. Critics hold that the institutional design of the ESAs is flawed, as "*the Treaty restrictions have led to a troublesome compromise in terms of [the ESAs] design, particularly with respect to Commission control and [the ESAs] independence*". This would have resulted in on the one hand an under-ambitious design for rule-making, and, on the other hand a too large extent of supervisory powers.[148] Moloney and Wymeersch both warn for the risk of over-centralisation, emphasizing that the practical needs of the markets and their supervision, namely the proximity of the supervisor and the knowledge of the local market, necessitate decentralisation of supervision.[149] Others, by contrast,

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[141] Which include: (a) observing a legally binding mediation role to solve disputes between national supervis ors, (b) adopting binding supervisory standards, (c) adopting binding technical decisions applicable to individual institutions, and (d) being in charge of the oversight and coordination of colleges of supervisors. European Commission 'Communication on European financial supervision' COM(2009) 252 final.
[142] E.O. Wymeersch, 'The Reforms of the European Financial Supervisory System: An Overview' (2010) 7 European Company and Financial Law Review 240, 253.
[143] A. Marcacci 'Public Enforcement' in *Regulating Investor Protection under EU Law* (Springer 2018), p. 245.
[144] Article 29 and Article 8(1)(b) of Regulation 1095/2010
[145] N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 429.
[146] Article 70 MiFID II.
[147] MiFID II, recital 141; Articles 70-72 MiFID II.
[148] N. Moloney, 'The European securities and markets authority and institutional design for the EU financial market: a tale of two competences: part (1) rule making'(2011) 12 European Business Organisation Law Review 41.
[149] See *inter alia*; Ibid.; N. Moloney 'EU financial market regulation after the global financial crisis: "more Europe" or more risks?'(2010) 47 Common Market Law Review 1317; E.O. Wymeersch 'Europe's new

suggest that the ESAs still lack the desired powers to deal with post financial crisis issues, which indicates that the framework did not achieve what is politically and economically desirable.[150] They have various reasons to believe that the role of the ESAs should be further enhanced.[151] Marcacci, for instance, concludes that "*the (over)reliance of the EU law on public enforcement mechanism is still an (over)reliance on coordination of NCAs, which sounds inconsistent with the very nature of the market integration objective at EU level and the political commitment to progress towards an ever closer union*".[152]

The Commission reviewed the functioning of the ESAs on several occasions. For instance in its 2014 Report on the operation of the ESAs and the ESFS.[153] This report outlined both major achievements and areas for improvement. The report finds that "*the work undertaken by the ESAs on the development of the single rulebook has contributed significantly towards enhanced regulatory harmonisation and coherence and has improved mutual understanding between supervisors*".[154] Nevertheless, it also found certain problems, mostly due to flaws in the institutional design. It was found that the regulations instituting the ESAs do not lay down a clear and stable architecture of the institutional relations between various authorities,[155] and the need for further clarification of the ESAs' legal basis and their role would be necessary.[156]

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financial regulatory bodies' (2011) 2 Journal of Corporate Law Studies 443. This was also largely the position of the UK government during the time of the introduction of the new institutional framework. See for instance: A. Darling, European financial regulation and supervision, letter to Miroslav Kalousek, Minister of Finance of the Czech Republic (3 March 2009). Available at: http://data.parliament.uk/DepositedPapers/Files/DEP2009-0735/DEP2009-0735.pdf, accessed 9 April 2019.

[150] See for instance: E. Fahey, 'Does the Emperor have financial crisis clothes? Reflections on the legal basis of the European banking authority' (2011) 74 Modern Law Review 581.

[151] For example, Weatherhill argued that Home state authorities' efforts might be sub-optimal in a cross-border situation as they might lack the capacity to deal effectively with supervision in a cross-border context. They might not have the interests of the host state investors or consumers in mind. Or more generally, they might fail to integrate in their calculations the consequences of their courses of action for host Member States. See: S. Weatherill, 'Pre-emption, Harmonisation and the Distribution of Competence to Regulate the Internal Market' in C. Barnard and J. Scott, *The Law of the Single European Market: Unpacking the Premises* (Hart Publishing 2002). This was also the position of Germany at the time of the introduction of the new institutional framework. See: A. van Loon, 'Domestic politics and national differences in restructuring EU financial supervision' (2018) 19 European Politics and Society 252, 253-255.

[152] A. Marcacci 'Public Enforcement' in *Regulating Investor Protection under EU Law* (Springer 2018), p. 246. Referring to: European Council, 'Solemn Declaration on European Union—Stuttgart 19 June 1983' (Stuttgart Bulletin of the European Communities, No. 6/1983).

[153] European Commission, 'Report from the Commission to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS)' COM (2014) 509 final.

[154] Ibid., p. 5.

[155] E. Chiti, 'In the Aftermath of the Crisis: The EU Administrative System between Impediments and Momentum'(EUI Working Papers LAW 2015/13), p. 3.

[156] G. Tsagas, 'The Regulatory Powers of the European Supervisory Authorities: Constitutional, Political and Functional Considerations' in G. Deipenbrock and M. Andenas, *Regulating and Supervising European Financial Markets. Risks and Achievements* (Springer, 2016).

Also in its 2017 ESA Consultation Paper,[157] the Commission considers to optimize existing tasks and powers[158] and to endow ESMA with new direct supervisory powers.[159] The Public Consultation focused on a number of issues in the area of tasks and powers, governance, supervisory architecture and funding. 227 responses to the consultation were received, coming from public authorities, industry associations, trade unions, consumer organisations, companies and private individuals. The results feed into the review of the EFSF.[160]

With regard to supervisory convergence, the ESAs and other stakeholders reported that there is insufficient use of the toolbox granted by the ESA Regulations, for instance peer reviews and on-site visits, the governance set-up of the ESAs, which might prevent them from adopting a more integrated EU approach to decision-making on the use of more effective tools and the lack of effective tools which render the ESA's intervention ineffective in certain cases.[161] The respondents have diverging views on the scope of powers for the ESA's – while some object to increasing ESAs' powers, highlighting the need to respect the principles of subsidiarity and proportionality and NCAs' room for discretion in their day-to-day supervision, others point to persisting regulatory barriers across the EU and call for greater harmonisation and suggest that ESMA become a fully-fledged capital markets supervisor.[162] Most respondents however agree that the ESAs should have a greater role in improving supervisory convergence, to make sure that legal acts are interpreted and applied in a convergent and consistent manner. Some respondents point to weaknesses in the ESAs' use of their powers, citing cases where ESAs had not acted at all, very late, or not communicated actions publicly.[163]

With regard to consumer and investor protection, there was a general perception that it had not been given sufficient priority in the work of the ESAs. Again, respondents had different views on whether the ESAs' powers should be extended or not, for instance by giving ESAs the right to prohibit or restrict certain products for investor protection purposes, but generally they agreed that the ESAs should use their existing powers more efficiently.[164] The Commission mentioned that "*while the ESAs have started to shift attention and resources to analyse risks to consumers and investors (...) work in this area must*

[157] European Commission, *Public Consultation on the Operations of the European Supervisory Authorities* (2017).
[158] Eight important points are developed under this section: (1) work on supervisory convergence; (2) non-binding measures; (3) work on consumer and investor protection; (4) enforcement powers; (5) international aspects of the ESAs' work; (6) access to data; (7) powers in relation to reporting; and, (8) financial reporting. Ibid.
[159] European Commission, *Public Consultation on the Operations of the European Supervisory Authorities* (2017), p. 16.
[160] Ibid., p. 2.
[161] Ibid., p. 7-8.
[162] European Commission, *Feedback statement on the public consultation on the operations of the European Supervisory Authorities having taken place from 21 March to 16 May 2017* (2017), p. 5-7.
[163] Ibid., p. 5.
[164] European Commission, *Public Consultation on the Operations of the European Supervisory Authorities* (2017), p. 9-10; European Commission, *Feedback statement on the public consultation on the operations of the European Supervisory Authorities having taken place from 21 March to 16 May 2017* (2017), p.8.

be accelerated".[165] Even though the ESAs have been devoting resources and efforts to consumer and investor protection, several legal provisions of the ESAs aimed at protecting investors were not used or even sometimes not complied with.[166] Some respondents state that the ESAs have not used their powers to prohibit or restrict certain financial activities that harm financial users, and have also not used their powers to deal with any breach of EU law in the area of user protection.[167]

There are thus still many weaknesses in the public enforcement system. Due to fragmentation of supervision and enforcement in EU Member States and lack of enforcement at both national and European level, many MiFID violations continue largely unabated.[168] Better Finance found in its Report on Mis-selling of financial products,[169] in relation to investment funds, widespread violations on MiFID provisions on fair and not misleading information, including the requirement that information be intelligible for the average target client, widespread violations on the MiFID provisions requiring to present the potential benefits in balanced way, also stating 'any relevant risks' related to the product, and provisions against disguising and obscuring important items and warnings,[170] and violations of the provisions on inducements of MiFID.[171] Despite repeated complaints to the NCAs, the competent authorities often failed to take action, with the result that the violations could continue to take place.[172] This brought Better Finance to the conclusion that "*the mis-selling of saving and investment products is a major issue of enforcement and supervision as several key EU regulatory provisions regarding retail investor and saver protection are not properly enforced*".[173]

A similar conclusion was also found in the 2018 study on mis-selling of financial products in the EU, which was carried out by the Policy Department for Economic, Scientific and Quality of Life Policies at the request of the ECON Committee.[174] After studying different cases of mis-selling, the report

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[165] European Commission, *Public Consultation on the Operations of the European Supervisory Authorities* (2017), p. 3.
[166] Better Finance, *Better Finance Response to the European Commission Consultation "Building a Capital Markets Union"* (2015).
[167] Ibid. For instance, Better Finance notes that "To our knowledge and experience, ESMA has never deployed its power to investigate breaches of EU Law (article 17 of the ESAs Regulations) in the area of consumer protection, even after a request to investigate such a breach from the Stakeholder Group (SMSG) itself".
[168] Better Finance, *A major enforcement issue: the mis-selling of financial products* (Briefing Paper April 2017), p. 16-17; Policy Department for Economic, Scientific and Quality of Life Policies, at the request of the ECON Committee, *Mis-selling of Financial Products: Subordinated Debt and Self-placement* (IP/A/ECON/2016-17, 2018), inter alia p. 17.
[169] Better Finance, *A major enforcement issue: the mis-selling of financial products* (Briefing Paper April 2017.
[170] Ibid., p. 16: there were often "*no warnings on the very high level of fees, on the outright and repeated failure not to even get close to the stated investment objective since inception, the impossibility to achieve this also in the future due to the level of fees, and on the massive destruction of value (after inflation) over the years*".
[171] Ibid., p. 16: "*especially those requiring the disclosure of the existence and of the amount of inducements [were] nowhere to be found on the online distributor's website*".
[172] Better Finance, *A major enforcement issue: the mis-selling of financial products* (Briefing Paper April 2017).
[173] Ibid.
[174] All 5 studies of the ECON Committee regarding mis-selling of financial products. Policy Department for Economic, Scientific and Quality of Life Policies, at the request of the ECON Committee, *Mis-selling of Financial Products* (IP/A/ECON/2016-17, 2018)

concluded that the "*weak enforcement of MiFID rules rather than weak regulation was responsible for mis-selling*".[175] The study demonstrated that there have been systematic violations of MIFID requirements by investment firms throughout the EU. The consequences of which could have been limited if there had been a strong public enforcement. However, the supervisors were not well-equipped to deal with violations of MiFID requirements; either because they lacked (human) resources to oversee something what might happen in any branch in any location of their Member State and to enforce the MiFID requirements on a real-time basis,[176] or because there was not sufficient transparency between authorities, making it difficult to assess the risk of investment firms failing to meet the MiFID requirements.[177]

In conclusion, while there has been substantial progress on the enforcement of conduct of business rules, there is still a lot of room for improvement in supervision and enforcement. The supervision and enforcement is still fragmented and competent authorities seem to sometimes lack the powers, capacity or willingness to timely intervene and to stop the violation, before damage occurs.

2.3 Compensation

Where violations of the conduct of business principles result in mis-sellings, the investor should have right to remedies. One of the main purposes of the EU investor protection regime is to empower investors to make adequate use of their rights.[178] The prevailing assumption that the empowered investor can, actually, make adequate use of its rights (by exercising informed choice, driving the development of appropriate services and products and monitoring intermediaries and product providers)[179] depends

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175 Policy Department for Economic, Scientific and Quality of Life Policies, at the request of the ECON Committee, *Mis-selling of Financial Products: Subordinated Debt and Self-placement* (IP/A/ECON/2016-17, 2017), in particular para 2.2.5. *Nota bene*: similar conclusions were drawn by the EU Commission. See: European Commission, 'Impact assessment accompanying the proposals for a Directive on Markets in financial instruments [Recast] and for a Regulation on Markets in financial instruments' COM(2011) 656 final; European Commission, 'Impact Assessment accompanying the document on reinforcing sanctioning regimes in the financial services sector' COM(2010) 716 final.

176 The research inter alia showed that "the supervisory authorities can also disclose warnings to retail investors on their official website but they are usually not read by them. Therefore, securities supervisors have to base their enforcement action, through desk-based and routine visits, on a risk-based approach". Policy Department for Economic, Scientific and Quality of Life Policies, at the request of the ECON Committee, *Mis-selling of Financial Products: Subordinated Debt and Self-placement* (IP/A/ECON/2016-17, 2017), p. 32. This was also concluded by: European Securities and Markets Authority (ESMA), MiFID Suitability Requirements (Peer Review Report, ESMA/2016/584), p. 10, 13.

177 Policy Department for Economic, Scientific and Quality of Life Policies, at the request of the ECON Committee, *Mis-selling of Financial Products: Subordinated Debt and Self-placement* (IP/A/ECON/2016-17, 2017), p. 32

178 Emil Paulis, at the time Director of the Financial Services Policy and Financial Markets Directorate, in the Summary of the Technical Workshop on Packaged Retail Investment Products (22 October 2009), p.2. Also see: N. Moloney, 'Designing a retail investor protection regime I. Why intervene in the retail markets? Encouraging the empowered investor, shielding the irrational investor or supporting the trusting investor?' in How to Protect Investors: Lessons from the EC and the UK (Cambridge University Press, 2010), p. 47-67.

179 N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 442.

in part on the assumption that effective and accessible redress mechanisms are available. Likewise, regulatory effectiveness depends on this assumption. Efforts to encourage firms to uphold high levels of investor protection are incomplete when firms are not sufficiently incentivized, in terms of litigation[180] and reputational risks,[181] by the threat of investor action.[182] Moreover, the existence of effective redress systems is also linked to cross-border activity and confidence in the financial market. As the Commission remarks in its Consumer Agenda,[183] if consumers were to have confidence in the internal market, they need to have confidence in effective and efficient enforcement of their rights and the availability of speedy and cost-effective redress and supported alternative dispute resolution (ADR) mechanisms.

Effective redress mechanisms are thus key to investor protection and investor confidence in financial markets. Nevertheless, MiFID II does not regulate or intend to harmonize such redress systems. Previously, under MiFID I, none of the provisions explicitly granted rights to investors as regards the conduct of business rules or contains remedies empowering such investors to take action in cases where an investment firm does not comply with the conduct of business rules.[184] Under MiFID II, Article 69 now refers to such a right as it requires that "*Member States shall ensure that mechanisms are in place to ensure that compensation may be 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 [MiFIR]"*. However, there is no guidance as to how the rights to compensation or other remedial action should be exercised. The determination of the appropriate institutions and remedies remains under the discretion of EU Member States.[185] These institutions and remedies can either be public (administrative or, perhaps, even criminal actions may be available) or private (either collective or individual action may be available). The next two chapters will more extensively address private and public redress mechanisms.

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[180] E. Ferran, 'Cross-Border Offers of Securities in the EU: The Standard Life Flotation' (2007) 4 European Company and Financial Law Review 461.
[181] L. Burn and B. Wells, 'The Pan-European Retail Market: Are We There Yet?' (2007) 2 Capital Markets Law Journal 263, 275.
[182] N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 442-443.
[183] European Commission, 'Communication on a European Consumer Agenda: Boosting confidence and growth' COM(2012) 0225 final. Redress was earlier highlighted in European Commission, 'Communication on a European Consumer Agenda: Boosting confidence and growth' COM(2012) 0225 final; European Commission, 'Consumer Empowerment in the EU' SEC(2011) 469 final; European Commission, 'Communication on EU Consumer Policy Strategy 2007–2013: Empowering Consumers, Enhancing Their Welfare, Effectively Protecting' COM(2007) 99 final; European Commission, 'Communication on Healthier, Safer, More Confident Citizens: A Health and Consumer Protection Strategy' COM(2005) 115 final; European Commission, 'Communication on Consumer Policy Strategy' COM(2002) 208 final.
[184] O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 408.
[185] On this topic, see: H.W. Micklitz, 'The Transformation of Enforcement in European Private Law: Preliminary Considerations' (2015) 23 European Review of Private Law 491.

CHAPTER 3: Private Redress

3.1 Introduction

Private enforcement by individuals plays a large role in the investment service sector, especially in the context of investment advice. In the words of Moloney "*Market mechanisms which promote good behaviour by investment firms depend, in part, on the active policing by investors of firm failures, particularly with respect to investment advice. The development of an effective retail investor constituency includes, therefore, the development of a cohort of investors empowered, and sufficiently informed, to monitor investment firms (...) and to exercise liability rights, whether contractual or otherwise*."[186]

As seen in the previous chapter, there is, however, no harmonized law providing private remedies for infringement of the conduct of business rules (or any other MiFID infringement). MiFID II is mainly publicly oriented and therefore only harmonizes, to a certain extent, sanctioning tools of public supervisors. Similarly, there are no common EU rules on individual or collective private redress mechanisms and the contractual consequences of a breach of MiFID conduct-of-business rules are still handled by domestic legal orders.[187] The European Court of Justice explicitly refrains from meddling into the relationship between EU public-law conduct of business rules and the domestic private-law conduct of business rules. As it has stated in the *Genil 48/Bankinter* case "*It is for the internal legal order of each Member State to determine the contractual consequences where an investment firm offering an investment service fails to comply with the assessment requirements laid down in Article 19(4) and (5) of Directive 2004/39*".[188]

In the absence of EU law providing for sanctions for violations of the conduct of business rules, investors are dependent on their national systems. However, these systems strongly differ from one state to another, resulting in inequality with regard to access to justice and ease of obtaining relief. For instance, the way in which public rules, such as the conduct of business rules, affect the civil-law relationship between investment firms and their clients, strongly varies across national systems. In some Member States, violations of the conduct of business rules may directly provide a ground for compensation, in others still many other criteria will have to be fulfilled.

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[186] N. Moloney, 'Effective Policy Design for the Retail Investment Services Market: Challenges and Choices Post Fsap' in G. Ferrarini and E.O. Wymeersch, *Investor Protection in Europe: Corporate Law Making, the Mifid and Beyond* (OUP 2006), p. 425. As also mentioned by O.O. Cherednychenko, 'Public and Private Enforcement of European Private Law in the Financial Services Sector' (2015) 23 European Review of Private Law 621, p. 633–634.

[187] A. Marcacci 'Public Enforcement' in *Regulating Investor Protection under EU Law* (Springer 2018), p.279.

[188] Case C-604/11, *Genil 48 SL and Comercial Hostelera de Grandes Vinos SL V Bankinter SA and Banco Bilbao Vizcaya Argentaria SA* EU:C:2013:344.

There are also other factors complicating private enforcement for investors. As retail investment disputes are often very complex, and the amounts at stake may be relatively small compared to the costs the litigation brings, investors may be deterred from bringing a civil claim. Certain mechanisms, such as alternative dispute resolution or collective redress, may provide cheaper, easier and faster ways of dispute resolution and so facilitate access to justice. However, at the moment, these mechanisms are not available in all Member States, or their access or quality may be limited. The European "New Deal for Consumers"[189] aims to tackle some of these issues. However, this Proposal is also has its flaws.

3.2. Interplay between public rules and private enforcement

There is a lot of debate on the effect the MiFID conduct of business rules on private enforcement in the EU Member States. MiFID II itself does not contain clear provisions on the possible private law nature of the obligations it imposes on investment firms, nor about the possible influence of the provisions of the Directive on private national law. This is remarkable: harmonization of investor protection is a key objective of the Directive, but the final element of investor protection – liability for breach of the conduct of business rules - is not regulated and left to Member States.[190] In a Public Consultation in 2010, the Commission made the suggestion to include a principle of civil liability in MiFID II.[191] However, the MiFID II proposal,[192] which was published less than a year later, did not pay any attention

[189] European Commission, 'Communication: A New Deal for Consumers' COM(2018) 183 final; European Commission, 'Proposal for a Directive on representative actions for the protection of the collective interests of consumers, and repealing Directive 2009/22/EC' COM(2018) 184 final; European Commission, 'Proposal for a Directive amending Council Directive 93/13/EEC of 5 April 1993, Directive 98/6/EC of the European Parliament and of the Council, Directive 2005/29/EC of the European Parliament and of the Council and Directive 2011/83/EU of the European Parliament and of the Council as regards better enforcement and modernisation of EU consumer protection rules' COM(2018) 185 final. *Nota bene*, the New Deal for Consumer encompasses financial services. The New Deal for Consumers however is specifically addressed to consumers. It is unclear whether all types of retail investors can rely on the rights enshrined in the New Deal for Consumers. It is possible that certain persons that fall within the category of 'retail investors' for the purposes of enhanced investor protection in MiFID II may not qualify as 'consumer' for the purposes of the New Deal for Consumers.

[190] D. Busch, 'Het "civiel effect" van MiFID: Europese invloed op aansprakelijkheid van vermogensbeheerders (2012) 12 Ondernemingsrecht 67; M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303.

[191] European Commission, Director General Internal Market and Services, *Public consultation: review of the markets in financial instruments directive (MiFID)* (2010), p. 63 et seq. Also see: D. Busch, 'MiFID II: Europese aansprakelijkheid van beleggingsondernemingen?' (2011) 13 Tijdschrift voor Financieel Recht 57, p. 57-58. D. Busch, 'Drie fundamentele vragen voor de Europese Commissie', (2010) 59 Ondernemingsrecht 294, p. 294-295.

[192] European Commission, 'Proposal for a Directive on markets in financial instruments repealing Directive 2004/39/EC of the European Parliament and of the Council [Recast]' COM (2011) 656 final; European Commission, 'Proposal for a Regulation of the European Parliament and of the Council on markets in financial instruments and amending Regulation [EMIR] on OTC derivatives, central counterparties and trade repositories' COM(2011) 652 final. For more information, see: C.M. Grundmann-van de Krol, 'Voorstel MiFID II en MiFIR: grotere reikwijdte, meer regels, veel werk voor ESMA en minder lidstaatopties' (2011) 117 Ondernemingsrecht 581, p. 581-589.

to the impact of its provisions on civil liability law. This silence aptly illustrates how sensitive the issue of European harmonization of civil law apparently is.[193]

It is notable that, although the conduct of business rules are contract-related rules governing the behaviour of investment firms in relationship to their clients (which is *per se* a contractual relationship), these rules are not written for and from the perspective of private law enforcement.[194] As stated before, MiFID does not explicitly grant rights to investors as regards the conduct of business rules or contains remedies empowering investors to take action in cases where an investment firms does not comply with these rules. In fact, from the text of MiFID II (and its predecessors) it is clear that the Directive is predominantly written from the perspective of public enforcement of the investor protection provisions contained therein by the national supervisors.[195]

For example, Article 70 of MIFID II determines that "*Member States shall lay down rules on and ensure that their competent authorities may impose* administrative *sanctions and measures applicable to all infringements of this Directive (...), and shall take all measures necessary to ensure that they are implemented*." In the same line, Article 67(2) requires Member States to establish *public* authorities to ensure the effective enforcement of the MiFID rules.[196] These provisions unambiguously put the directive into an administrative, public, framework. The fact that these provisions, as well as the majority of other provisions, address the Member States rather than individuals underscores the public character of the framework.[197]

Against this background, it is not surprising that MiFID II, including the contract-related conduct of business rules, is often implemented by Member States within the financial supervision legislation

[193] D. Busch, 'Het "civiel effect" van MiFID: Europese invloed op aansprakelijkheid van vermogensbeheerders (2012) 12 Ondernemingsrecht 67; N. Moloney, *EC Securities Regulation* (OUP 2008), p. 641; M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303, p. 310; V.P.G. de Serière, 'Het zich verlaten op adviezen of informatie van derden in de financiële sector' (2011) 53 Ondernemingsrecht 264.
[194] O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403. Referring to: H.W. Micklitz, H.-W., 'Anlegerschutz—analyse des EG-rechts' in J. Keßler and H.W. Micklitz, *Anlegerschutz in Deutschland, Scweiz, Großbritannien, USA und der Europäischen Gemeinschaft* (Nomos Verlagsgesellschaft 2004), p. 324.
[195] O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' 33 Journal of Consumer Policy 403.; C.M. Grundmann-van de Krol, *Het effectenrecht tussen publiek- en privaatrecht* (Boom Juridische uitgevers 2002), p. 4; H.W. Micklitz, H.-W., 'Anlegerschutz—analyse des EG-rechts' in J. Keßler and H.W. Micklitz, *Anlegerschutz in Deutschland, Scweiz, Großbritannien, USA und der Europäischen Gemeinschaft* (Nomos Verlagsgesellschaft 2004), p. 324.
[196] Also see MiFID II, recital 58.
[197] V.P.G. de Serière, 'De rechtsverhouding tussen de belegger en beleggersonderneming: De aard van de Unierechtelijke voorschriften' in *Mr. C. Assers Handleiding Tot De Beoefening Van Het Nederlands Burgerlijk Recht Asser* 2-IV.

and not within the civil codes or consumer protection legislation. As a result, the conduct of business rules are generally considered to be of a public law nature.[198]

Yet it cannot be said that these rules do not involve, or at least effect, civil law rights and obligations. After all, the provisions govern the relationship between investment firms and their clients, and this relationship is by definition of a civil law nature.[199]

This seems to be confirmed by Article 74(2) – on collective actions in the interest of harmed consumers-, Article 75 – on out-of-court settlement of disputes between investors and investment firms- and Article 69(2) – on mechanisms for compensation or other remedial action for damages suffered-, which contain procedural rules for the settlement of disputes between investors and investment firms. However, as the European Court of Justice made clear in *Genil 48/Bankinter:* "*although [Article 70] 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 [the conduct of business rules], 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*."[200] In this judgment the Court explicitly refrains from mandating Member States to attach civil-law consequences to violation of conduct of business rules. Rather, the Court indicates that the potential availability of such consequences are at the discretion of the Member States. This discretion is, however, restricted by the principles of equivalence and effectiveness.

Consequently, the question arises as to whether the effectiveness (*effet utile*) of the investor protection provisions of MiFID II is thwarted when a Member State denies the provisions of the Directive any civil-law influence.[201] This question is to be answered with reference to the aims and objectives of the Directive. From the philosophy and the context of MiFID II, which emphasise the need for a high level of investor protection,[202] as well as the level of detail and the degree of precision of the conduct

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[198] See amongst many others: O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403; C.M. Grundmann-van de Krol, *Het effectenrecht tussen publiek- en privaatrecht* (Boom Juridische uitgevers 2002).
[199] V.P.G. de Serière, 'De rechtsverhouding tussen de belegger en beleggersonderneming: De aard van de Unierechtelijke voorschriften' in *Mr. C. Assers Handleiding Tot De Beoefening Van Het Nederlands Burgerlijk Recht Asser* 2-IV.
[200] Case C-604/11, *Genil 48 SL and Comercial Hostelera de Grandes Vinos SL V Bankinter SA and Banco Bilbao Vizcaya Argentaria SA* EU:C:2013:344, paragraph 57 and the case-law cited. This principle is also confirmed in later case law, see: Case C-312/14, *Banif Plus Bank* EU:C:2015:794.
[201] M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303, p. 305.
[202] See Chapter I of this thesis, as well as the Preamble of MiFID II.

of business rules in MIFID, it can be inferred that the *effet utile* of the directive may be insufficiently achieved by mere supervisory provisions, which only concern the relationship between the investment firms and the supervisors, and which would not have any third-party effect in the civil-law relationship between the investment firms and their investors.[203]

The idea that the MiFID conduct of business rules have legal consequences for this civil-law relationship between investment firms and their clients is therefore no longer disputed. The question is rather what the extent and the effect of these legal consequences are. This question is inextricably linked to the technique whereby the provisions of EU law have impact in the civil sphere and is essentially answered in accordance with the national laws of the Member States.[204] It is, therefore, unsurprisingly, answered differently by legal scholars across the Member States.

For instance, in German legal literature, different approaches are taken, but with similar outcomes: the conduct of business rules can be conceived either as rules of a dual nature (being both supervisory and civil-law norms)[205] or as predominantly supervisory rules with a consequential effect (*Reflexwirkung*) on civil law.[206] In the Netherlands, the conduct of business rules are conceived as a part of the general duty of care of parties to a contract[207] or a special, non-contractual duty of care of investment firms towards their clients.[208] In practice, the Dutch requirement of 'relativity' or 'proximity', pursuant to which a violation of a legal rule can only lead to liability towards persons alleging damages as a consequence of this violation if the said rule is intended to protect their interest,[209] does not cause many problems for the acknowledgement of claims for damages.[210] In Belgium and French law, the general system of civil liability leads to the integration of the conduct of business rules in the general duty of care, either in contractual or non-contractual matters.[211] As there is no principle of relativity, a violation

[203] See amongst (many) others: M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303.
[204] M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303, p. 308.
[205] Ibid., referring to: T. Möllers, in H. Hirte and T. Möllers, *Kölner Kommentar zum WpHG* (Carl Heymanns Verlag 2007), p. 1276-1277.
[206] Ibid., referring to: I. Koller, in H.D. Assmann and U.H. Schneider, *Wertpapierhandelsgesetz* (Verlag Otto Schmidt 2009), p. 1254. Also see: C. Winternitz, 'Anlegerschäden: Eine "Reflexwirkung" des Aufsichtsverhaltens' (2009) 3 Zeitschrift für Finanzmarktrecht 183.
[207] Art. 7:401 BW. De miskenning van de gedragsregelen impliceert bijgevolg contractbreuk: zie J.H. Lemstra and V.M. Neering, 'Civielrechtelijke handhaving' in D. Busch and C.M. Grundmann-van de Krol, *Beleggingsondernemingen* (Kluwer 2009), p. 1051.
[208] E.g. the special duty of care of investment firms in Article 4:24a Wet op het Financieel toezicht (Wft) (the Netherlands).
[209] Article 6:163 of the Dutch Civil Code. Also see the explanation in *Parlementaire geschiedenis van het nieuwe burgerlijk wetboek; Boek 6* (Kluwer 1990), p. 615.
[210] C.M. Grundmann-van de Krol, *Beleggingsondernemingen* (Kluwer 2009), p. 740.
[211] M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303. Also see e.g. P. van Cleynenbreugel, 'Gedragsregels in het financieel recht: Enkele beschouwingen over gedragsregels als rechtsbron naar aanleiding van de implementatie van MiFID in het Belgisch Recht', (2009) 1 Jura Fakonis 77; T. Bonneau 'France' in D. Busch and C. van Dam, *A Bank's Duty of Care* (Hart Publishing 2017).

of a conduct of business rule will *eo ipso* infringe the duty of care. In the United Kingdom there is a specific legal provision relating to the civil-law effects of the conduct of business rules for civil-law relationships: Article 138d of the Financial Services and Markets Act states that contravention of Rules,[212] including conduct of business rules, may be "*actionable at the suit of a private person who suffers loss as a result of the contravention*".

This comparative overview shows that legal systems approach differently the issue of whether conduct of business standards may have direct effect in civil law. In the UK, these standards may be directly invoked by private parties on the basis of Article 138d of the Financial Services and Markets Act. In contrast, in many other systems, in particular in Germany and the Netherlands, the conduct of business rules do not have direct effect between the investment firm and its client, and hence they cannot be directly invoked by the aggrieved investor.[213] More uniformity on the EU-level for civil-law remedial actions for aggrieved investors could be advantageous for several reasons, including decreasing the legal uncertainty and risks for investment firms wanting to perform activities in Member States with different civil liability regimes and boosting confidence of EU investors. Nevertheless, such harmonization will not likely be achieved, given the EU case-law on this matter, emphasizing the discretion of Member States, and the fact that, after some negative replies, there has not been a follow-up on the suggestion of the Commission in their Public Consultation to include a principle of civil liability in the MiFID regime. All this shows the unwillingness of the European legislator to intervene directly in the area of contract and civil liability law of the Member States. Still facing strong conceptual differences between Member States, the explicit regulation of MiFID codes of conduct as (pre-) contractual provisions and the incorporation of private consequences of their violation may disrupt the internal consistency of national civil-law systems,[214] and is therefore unlikely to take place in the near future.

3.3. Procedural difficulties

In the previous paragraph we have seen that the possibility for (direct) enforcement of the conduct of business rules by private parties may differ across Member States. Nevertheless, practically all Member States accept some legal consequences of violation of the conduct of business provisions on the civil-law relationship between investment firms and their clients, whether directly, through contractual provisions or through a (general) duty of care. However, even if a particular conduct of business rule may, whether directly or indirectly, have effect in the relationship of investment service provider and

[212] This action for damages clause concerns all rules made by the Financial Conduct Authority (FCA) or the Prudential Regulation Authority (PRA), to the exception of the rules referred to in Article 138d(5) of the Financials Services Act (United Kingdom).
[213] Also see: O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403.
[214] M. Tison 'De civielrechtelijke dimensie van MiFID in rechtsvergelijkend perspectief' (2010) 61 Ondernemingsrecht 303, p. 303.

its client, this does not imply yet that the aggrieved investors have a genuine possibility of holding the investment firm liable for damages they have suffered as a result of breach of the conduct of business rules.[215] Whether such a possibility exists largely depends on the extent to which private litigation against investment firms are accessible to injured parties (including in terms of costs involved therein), both domestically and on a cross-border basis, and on how easy it is to obtain relief under the civil-law system of the Member State concerned.[216]

As far as the access to justice is concerned, there is an important role to play for collective actions and alternative dispute resolution (ADR) mechanisms. These mechanisms will be more extensively discussed in the following paragraphs.

As per the ease of obtaining relief, it is must be clear that, even if the breach of a particular conduct of business rule has effect in the relationship of the investment provider and its client, it does not yet mean that the investment firm is liable for damage. For this purpose, all criteria for liability (or rescission or termination of the contract) of the civil doctrine in which the injured person brings its claim must be met. For example, for a successful claim for damages in Dutch contract law, it is not only necessary that there was a violation of a particular supervision standard and that this violation results in a breach of the duty of care of the investment firm. It must also be proven that this violation is imputable to the service provider, that the client has suffered loss and that there is causal link between the breach of the rule and the loss suffered by the client. In addition, as noted above, the relativity requirement must also be met if in case of a claim on the basis of breach of the duty of care, a specific public-law rule is invoked.[217] Also article 6:101 of the Dutch Civil Code on 'own fault' can play a role, when the damage was wholly or partly attributable to the injured investor himself.

As a rule, the burden of proof of the conditions for a successful claim is on the aggrieved investor. In practice, however, it may not always easy for the investor to prove them. Particular difficulties may arise to the proof of a causal link between the breach of the conduct of business rules and the damage occurred by the investor. This can for example be difficult to proof when the investor has suffered damages due to unclear information or a missing warning of the risk involved in a certain investment.[218]

[215] O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 412.
[216] See: O.O. Cherednychenko, 'De bijzondere zorgplicht van de bank in het spanningsveld tussen het publiek- en privaatrecht' (2010) 27 Nederlands Tijdschrift voor Burgerlijk Recht 66.
[217] Article 6:163 of the Dutch Civil Code. As Cherednychenko explains: "The relativity [requirement] plays a decisive role in determining whether the violation of a certain supervision standard contained in the Financial Supervision Act 2007 has effect in the investment service provider–client relationship via general private law concepts, such as the general duty of care in tort or contract embodied in arts. 6:162 and 7:401 of the Civil Code, respectively." O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' 33 Journal of Consumer Policy 403, p. 411.
[218] See O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 414; O.O. Cherednychenko, 'De bijzondere zorgplicht van de bank in het spanningsveld tussen het publiek- en privaatrecht' (2010) 27 Nederlands Tijdschrift voor Burgerlijk Recht 66.

Because of these difficulties, some courts have adopted a presumption that, in cases where the investment firm has failed to comply with his information duties, the aggrieved individual investor would not have made an investment if he was provided with the correct information.[219] Such rules are however not provided for in MiFID II or its implementing standards, therefore it wholly depends on the domestic civil law systems whether such reverse of the burden of proof may be available.

Other issues may also complicate the possibility for investors to bring a successful claim. For example, since the risks involved in many financial and investment agreements often do only materialize over a long period of time, it can take a while before the investor can revert to civil-law courts to determine the breach of the conduct of business rule and to ask for compensation.[220] Moreover, there is a general reluctance of investors to start private litigation, since this is a costly, complex and financially risky process.[221] Generally there are relatively small amounts at stake, the costs of litigation are therefore relatively high and the incentive for investors to bring a claim little.[222] On top of this, there are many information asymmetries,[223] which not only make the proceedings, and in particular the bringing of proof, more complex, but which may even result in the situation that the investor is not at all aware that his (information) rights have been violated. All of these difficulties are exacerbated in the cross-border context.[224]

3.4 Alternative dispute resolution (ADR) mechanisms

Given the costs and complexities of litigation, ADR mechanisms are central to the resolution of investor claims.[225] The classic rationale for ADR associates it with quick, effective, flexible and cheap dispute

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219 BGH, 12 May 2009, WM 2009, 1274.

220 O.O. Cherednychenko, 'De bijzondere zorgplicht van de bank in het spanningsveld tussen het publiek- en privaatrecht' (2010) 27 Nederlands Tijdschrift voor Burgerlijk Recht 66.

221 See for example: C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 832.

222 As explained inter alia by Professor MacNeil: "For private enforcement to work, the expected recovery must exceed the costs". When the expected compensation is low, and the costs of bringing proceedings (relatively) high, there is insufficient incentive for the aggrieved investor to bring a claim against the investment firm. I. MacNeil, 'Enforcement and Sanctioning' in N. Moloney, E. Ferran and J. Payne *The Oxford Handbook of Financial Regulation* (OUP 2015).

223 N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010). *Nota bene* "investor and retail financial services issues are often too complex and too technical and legal advice too costly for individuals to effectively obtain individual redress through court". Better Finance, *A major enforcement issue: the mis-selling of financial products* (Briefing Paper April 2017, p. 23.

224 FIN-USE, 'FIN-USE Response to the Green Paper on Financial Services Policy (2005–2010)' (2005), p. 9.Notably, "Language difficulties can be significant, redress mechanisms must be identified and remedies and procedures differ". N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 447; P. Nebbia and T. Askham, *EU Consumer Law* (Richmond Law & Tax 2004), p. 16–17; S. Weatherill, *EU Consumer Law and Policy* (Edward Elgar Publishing 2005), p. 235–236.

225 E.O. Wymeersch, 'The Structure of Financial Supervision in Europe: About Single, Twin Peaks and Multiple Financial Supervisors' (2006) 8 European Business Organization Law Review 237.; Joint Forum, 'Customer suitability in the retail sale of financial products and services' (2008), p. 20.

resolution.[226] Especially where large-scale mis-sellings take place, institutionalized ADR can be considerably more effective in compensating investors than private litigation.[227] Even though there are also risks relating to ADR,[228] ADR procedures for consumer disputes, including investment disputes, involving mediation and/or arbitration elements, are common across the Member States.[229] They vary considerably, however, with respect to the extent to which they provide mediation or arbitration services or both, and their form. (e.g. in the form of ombudsmen, mediators or complaint boards).[230] Although the ombudsman model dominates,[231] consumer complaint boards, mediators, arbitration bodies and complaints schemes within supervisors are all used in financial services and investment disputes. They vary in terms of their coverage from consumer complaints in general, to financial services complaints in general, to sector-specific complaints (with respect to banking, insurance or securities). Their procedures also vary, taking different approaches to, for example, costs, legal assistance, the complaints process, formalities, evidence, confidentiality, time limits, monetary limits on awards and the binding or non-binding nature of decisions.[232] Lastly, they vary with respect to how awards/decision are made; while some schemes are based on the application of the relevant (domestic or European) rules, others operate from general principles. There are, thus, many differences between the available systems within Member States, *inter alia* relating to the degree of protection they offer to investors. Some Member States have rather well-developed informal dispute resolution bodies, operating as an alternative to

[226] See e.g. Katholieke Universiteit Leuven, An Analysis and Evaluation of Alternative Means of Consumer Redress Other Than Redress through Ordinary Judicial Proceedings (Final Report 2008), p. 6; European Commission, Public Consultation on Prevention and amicable resolution of disputes between investors and public authorities within the single market (2017). For more information on ADR mechanisms in financial disputes, see, for instance: S.F. Ali, Consumer Financial Dispute Resolution in a Comparative Context : Principles, Systems and Practice (Cambridge University Press 2013).

[227] For example, "ADR bodies may (...) become entangled in standard-setting but without the controls typically placed on law-making. This is particularly the case where individual complaints reflect systemic failures or where determinations are made as to good or bad practice". N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 452; . I. MacNeill, *An Introduction to the Law on Financial Investment* (Hart Publishing 2004), p. 187.

[228] For more information on the drawbacks of ADR mechanisms in financial disputes, see, for instance: S.F. Ali, *Consumer Financial Dispute Resolution in a Comparative Context : Principles, Systems and Practice* (Cambridge University Press 2013); Katholieke Universiteit Leuven, *An Analysis and Evaluation of Alternative Means of Consumer Redress Other Than Redress through Ordinary Judicial Proceedings* (Final Report 2008).

[229] N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 452 .

[230] Ibid., p. 452; O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 413.

[231] Katholieke Universiteit Leuven, *An Analysis and Evaluation of Alternative Means of Consumer Redress Other Than Redress through Ordinary Judicial Proceedings* (Final Report 2008), p. 84-85.

[232] Ibid., p. 125-152; N. Moloney, 'Supervision, enforcement and redress' in *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010),p. 452-453.

civil-law courts.[233] In a number of Member States, however, ADR bodies in the area of financial and investment services are, or were for a long time, either non-existent or underdeveloped.[234]

The improvement of ADR mechanisms, especially in the field of financial services, received special attention during and after the financial crisis. In its 2008 resolution on the Green Paper on retail financial services,[235] the European Parliament recalled that consumers should have access to ADR mechanisms, both at national and cross-border level, and called on the Commission to assess the issue and to promote best practices. In that same year, the Commission started a consultation process with a view to improve the effectiveness of national ADR schemes.[236] Simultaneously, the Commission carried out several studies concerning ADR in Europe.[237] All this led, at the end of 2011, to the proposal of a legislative act for a Directive on Alternative Dispute Resolution for consumer disputes (the ADR Directive), which was officially adopted in 2013. The ADR Directive specifies uniform quality standards in the context of ADR for consumer disputes within the Member States. These quality standards, relating to expertise and impartiality, transparency, effectiveness, fairness, liberty and legality,[238] were already set forth by Recommendations 98/257/EC and 2001/310/EC, but were, until the introduction of the ADR Directive, pure soft law standards.

The ADR Directive must "*be seen in the context of efforts to improve the functioning of the retail internal market and more particularly to enhance redress for consumers*".[239] The Directive applies to all disputes between consumers and traders concerning contractual obligations stemming from sales or services contracts, both online and offline, in all economic sectors, including, thus, the financial services and investment sector. The aim of the Directive is to overcome three particular shortcomings which hinder the effectiveness of ADR: gaps in the coverage, as well as lack of consumer and business awareness, and the uneven quality of ADR procedures. To do so, the Directive has four focus points:

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233 According to Cherednychenko, examples of such ADR bodies are the Financial Ombudsman Service (FOS) in the UK and the Financial Services Complaints Institute (Klachteninstituut Financiële Dienstverlening (Kifid) in the Netherlands. See O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 413.
234 O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 413, where she refers that this is mainly the case in the 'new' Member States. Also see: Katholieke Universiteit Leuven, *An Analysis and Evaluation of Alternative Means of Consumer Redress Other Than Redress through Ordinary Judicial Proceedings* (Final Report 2008), p. 161-188.
235 European Parliament, 'Resolution of 5 June 2008 on the Green Paper on Retail Financial Services in the Single Market' (2007/2287(INI)).
236 European Commission 'Consultation Document on Alternative Dispute Resolution in the Area of Financial Services' (2008).
237 European Commission, 'Study on the Use of Alternative Dispute Resolution in the European Union, Civic Consulting of the Consumer Policy Evaluation Consortium (Cpec)' (2009); European Commission, Consumer redress in the European Union: consumers' experiences, perceptions and opinions (2009); European Parliament 'Cross-Border Alternative Dispute Resolution in the European Union' (2011, PE 464.424)
238 Now laid down in Articles 7-11 of Directive 2013/11/EU on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC.
239 European Commission, 'Proposal for a Directive on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC' COM(2011) 0793 final.

(i) ensuring the ADR procedures exist for all consumer disputes; (ii) ensuring the adequate provision on information on ADRs, so that when disputes arise, consumers must be able to quickly identify which ADR entities are competent to deal with their dispute; (iii) ensuring high quality of ADR entities, so that such entities respect the quality principles of impartiality, transparency, effectiveness and fairness; and (iv) ensuring a public monitoring of ADR entities at national level, with each Member State appointing a competent authority in charge of monitoring the functioning of ADR entities established on its territory.[240] *Nota bene*, the grounding philosophy of the ADR is to help consumers obtain fast and cheap redress. Coherently, the Directive provides that access should be free of charge for the consumer, or, when this is not possible, costs should not exceed a nominal fee.[241]

The ADR Directive was soon followed by the Online Dispute Resolution (ODR) Regulation,[242] which establishes an online, pan-European platform run by the European Commission to help consumers and traders to resolve their disputes arising from online transaction on goods and services (including online financial services). The platform works as a single entry point for consumers and traders who want to submit a dispute: after receiving a claim, the platform forwards it to the relevant national ADR entities which will take care of the dispute.[243] This way, ADR settlement of disputes relating to online transactions between consumers (or retail investors) and traders (or investment firms) should be facilitated. Even though some cases have been successfully filed through the ODR platform, there is still a significant lack of awareness. Very few complaints were received via this platform in 2016.[244]

As regards MiFID II itself, Article 75(1) provides for compulsory establishment of ADR schemes at domestic level handling disputes relating to the provision of investment services and requires that all investment firms adhere to such schemes.[245] Article 75 also sets forth that national ADR bodies must actively cooperate with their counterparts in the resolution of cross-border disputes.

In 2015 the interest for another initiative for pan-European ADR mechanisms for retail financial services revamped: in its Green Paper[246] the Commission drew attention to the Financial Dispute Resolution Network (FIN-NET). This network was founded in 2001, aiming to facilitate the resolution of cross-border disputes out-of-court by creating a pan-European platform where national schemes can cooperate "*in order to provide consumers with easy access to alternative dispute resolution procedures*

[240] Ibid., paragraph 3.1.
[241] Directive 2013/11/EU on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC, recital 41.
[242] Regulation (EU) No 524/2013 on online dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC
[243] Ibid., recital 18.
[244] European Commission, *FIN-NET Activity Report 2016* (2017) <https://ec.europa.eu/info/file/fin-net-activity-report-2016_en> accessed 20 April 2019.
[245] A. Marcacci 'Private Enforcement' in *Regulating Investor Protection under EU Law* (Springer 2018), p. 290.
[246] European Commission, 'Green Paper on Retail Financial Services' COM (2007) 226 final.

in cross-border cases".[247] This voluntary and informal network brings together ombudsmen, arbitrators, adjudicators and other schemes across the EU.[248] The network works as follows: after the consumer contacts the ADR of the Member State where he has residence, this ADR shall decide which ADR in the financial services provider's Member State is competent, and it shall inform the consumer accordingly. Then, the files will be transferred to the competent ADR, either by the consumer or by the ADR of the consumer's home Member State, and the competent ADR in the financial service provider's home Member State is responsible to carry out an investigation and to adopt a decision or recommendation.[249] After the Commission's Green Paper, FIN-NET was updated in line with the ADR Directive: relevant changes to the Memorandum of Understanding[250] were made to align the network's operating rules to the quality criteria of the Directive. Now, only ADR schemes that are in line with Article 20(2) are eligible to join FIN-NET. Work is in progress for two other issues highlighted by the Commission's Green Paper relating to the FIN-NET: the ADR schemes that are members to FIN-NET do not yet cover all financial sectors (e.g. banking, payments, insurance, securities). However, the number of Member States that are benefiting from full-sector coverage is growing.[251] Also, as the general awareness was, and still is, low,[252] the Commission announced that it is preparing an awareness campaign.[253]

All these developments have contributed to the improvement of investors access to justice. Nevertheless, there is still much room for improvement. The ODR and FIN-NET platforms suffer from a lack of awareness and the European ADR schemes as harmonized under the ADR Directive are still not very developed and sophisticated: as of today, the Directive simply harmonizes certain features of domestically based ADR mechanism, does not directly provide for collective redress (see below), and does not require the participation of investment firms in ADR procedures to be mandatory or the outcome of such procedures to be binding on investment firms.[254] Especially this last point is highly criticized. As Fejős and Willett claim "*if the aim is consumer access to justice, and if this is understood in a way that is sensitive to consumer needs and vulnerabilities, then it is strongly arguable that*

[247] European Commission, The FIN-NET network <https://ec.europa.eu/info/node/43326_en> accessed 17 April 2019.
[248] European Commission, 'Green Paper on Retail Financial Services' COM (2007) 226 final.
[249] European Commission, *FIN-NET Activity Report 2016* (2017) <https://ec.europa.eu/info/file/fin-net-activity-report-2016_en> accessed 20 April 2019, p.2.
[250] Memorandum of Understanding on a Cross-Border Outof-Court Complaints Network for Financial Services. Accessible from: <https://ec.europa.eu/info/node/43326_en> accessed 17 April 2019.
[251] Compare: European Commission, *FIN-NET Activity Report 2015* (2016) <https://ec.europa.eu/info/sites/info/files/2015-activity-report_en.pdf> accessed 20 April 2019 with European Commission, *FIN-NET Activity Report 2016* (2017) <https://ec.europa.eu/info/file/fin-net-activity-report-2016_en> accessed 20 April 2019.
[252] Green Paper; European Commission, *FIN-NET Activity Report 2016* (2017) <https://ec.europa.eu/info/file/fin-net-activity-report-2016_en> accessed 20 April 2019.
[253] European Commission, 'Consumer Financial Services Action Plan: Better Products, More Choice', COM(2017) 139 final, p. 4.
[254] Directive 2013/11/EU on alternative dispute resolution for consumer disputes and amending Regulation (EC) No 2006/2004 and Directive 2009/22/EC, recital 49.

outcomes should be binding on businesses. There should be a final and enforceable outcome, without an option for the business to challenge the decision routinely, based on the substantive outcome. Rather, the business should only be able to challenge the outcome on the very limited grounds of a 'judicial review' type action. (...) Outcomes that are binding on the business have the potential to ameliorate the inherent inequalities between consumers and businesses, giving consumers fast and cost-effective ways to enforce their private law rights."[255]

3.5 Collective redress (collective litigation/ADR)

Another important instrument for improving access to justice is the possibility of collective redress. Collective redress refers to a wide range of judicial mechanisms for resolving mass disputes, i.e. disputes in which numerous claimants (either natural or legal persons), who have suffered similar harm, resulting from the same or similar illicit behaviour of a natural or legal person, bring a single action or procedure. This encompasses mechanisms that grant to a member of the affected group or to a representative entity standing to bring an action on behalf of the group in order to obtain either compensatory relief, injunctive relief, or both. [256] Collective redress actions have proven to be an effective tool to defend consumers' interests, including in the field of financial products and services.[257] It's effectiveness has been emphasized by economist, stating that it can be perceived as "*a self-correction mechanism of regulatory market failure by restoring justice through compensation and serves as a deterrent. It saves administrative costs because of economies of scale."*[258]

3.5.1 *Objectives of collective redress mechanisms*

As will be discussed below, there are many different type of collective redress mechanisms, and their goals may slightly differ from one to another. Nevertheless their overarching aim is to facilitate dispute resolution in general. Besides that, collective redress mechanisms have certain common objectives including (i) efficient legal protection, (ii) effective legal protection, and (iii) reduction of the administrative burden of the judiciary courts.[259]

The first important objective of collective redress mechanisms is to offer efficient legal protection to all parties to a mass dispute. When a single action causes a large group of individuals to suffer damage,

[255] A. Fejős and C. Willett, 'Consumer Access to Justice: The Role of the ADR Directive and the Member States' (2016) 24 European Review of Private Law 33.
[256] European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829), p.13.
[257] European Commission, 'Green Paper on Retail Financial Services' COM (2007) 226 final, giving as examples the collective redress actions launched in regard to life insurance products in France, and in relation to preferred shares and financial pyramid schemes in Spain.
[258] European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829), p. 17, 59-62.
[259] For an extensive discussion of these objectives, see T. Bosters, *Collective Redress and Private International Law in the EU* (Springer 2017); I.N. Tzankova et al. 'Effectieve en efficiënte afwikkeling van massaschade: terug naar de kern van het collectieve actierecht' in F.M.A. 't Hart et al., *Collectieve acties in de financiële sector* (NIBE-SVV 2009).

which is often the case in violations of the conduct of business rules and consequential mis-sellings, standard redress mechanisms do not offer an efficient way to resolve the dispute, since all individual claimants would have to file their claim individually. Given the risks, costs and other procedural difficulties explained in paragraph 3.2, there is a significant chance that individuals may be unmotivated to bring their claim in such circumstances. This was the reason in the first place for several national legislators to introduce systems for collective redress.[260] Collective redress mechanisms, compared to standard redress mechanisms, can be more efficient in terms of costs and time. By joining forces, victims are able to reduce the costs of legal representation and, for the courts (or other dispute resolution bodies),[261] it will take less time and other resources to resolve an entire mass dispute through a single collective action than to issue a single opinion in each individual case.

Another important objective is that of effective legal protection. Besides offering a (cost- and time-) efficient procedure, and thus providing more *efficient* legal protection, collective redress mechanisms are generally aimed at providing more *effective* legal protection than standard redress mechanisms. Especially where claimants have an individually non-recoverable claim, they could be left empty-handed if they have to use standard procedures.[262] As any possible compensation would not cover their costs, they would be devoid of incentives to start a procedure. Nevertheless, as collective redress procedures can be much cheaper, they may be able to recover some of their damages in a collective proceedings. Hence, collective redress mechanisms could offer a solution for injured parties in cases involving very small or complex (and thus costly) claims.[263] Another way in which collective redress mechanisms may offer more effective protection relates to the aspect of finality. Legal protection can be seen as more effective when a mass dispute is resolved entirely through the use of a single procedure

[260] For instance: Gesetzentwurf der Bundesregierung zum KapMuG, BT-Drucks, 15/5091, p. 16–17 (German KapMuG); Parliamentary Documents II, 1991–1992, 22486, nr. 3, pp. 3, 5, 7, 22–23 (Dutch collective action); Parliamentary Documents II, 2003–2004, 29414, nr. 3, pp. 2, 5, 6 (Dutch collective settlement). Also see: T. Bosters, *Collective Redress and Private International Law in the EU* (Springer 2017), p. 15; I.N. Tzankova et al. 'Effectieve en efficiënte afwikkeling van massaschade: terug naar de kern van het collectieve actierecht' in F.M.A. 't Hart et al., *Collectieve acties in de financiële sector* (NIBE-SVV 2009), p. 110 et seq.
[261] *Nota bene*, in this paragraph we will speak of courts, nevertheless the same reasoning can be applied to other dispute resolution bodies, such as ADR bodies.
[262] T. Bosters, *Collective Redress and Private International Law in the EU* (Springer 2017), p. 17
[263] This is also one of the objectives of the EU small claims procedure. See: Regulation (EC) No 861/2007 of the European Parliament and of the Council of 11 July 2007 establishing a European small claims procedure. This Regulation sets up a European Small Claims Procedure, whereby EU consumers and small businesses with claims up to €5.000 can bring a case before their local court against a party in another EU Member State. Unfortunately, the small claims procedure has so far not been very successful. See: European Commission, 'Report from the Commission to the European Parliament, the Council and the European Economic and Social Committee on the application of Regulation (EC) No 861/2007 of the European Parliament and of the Council establishing a European Small Claims Procedure' COM(2013) 795 final; European Commission, 'Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EC) No 861/2007 of the European Parliament and the Council of 11 July 2007 establishing a European Small Claims Procedure and Regulation (EC) No 1896/2006 of the European Parliament and of the Council of 12 December 2006 creating a European order for payment procedure' COM(2013) 794 final; E.A. Ontanu, *Cross-border Debt Recovery in the EU: a Comparative and Empirical Study on the Use of European Uniform Procedures* (Intersentia 2017).

(this applies especially in opt-out collective redress mechanisms).[264] The finality aspects prevents contradictory judgments. As all victims in the dispute (at least; those that are opted-in or those that did not opt-out) fall under the outcome of the decision, other procedures are not necessary.

A last objective, less relevant to the protection of investors or consumers, is the reduction of the administrative burden on the judiciary. As courts have only limited capacity to resolve disputes, they may become overburdened when all victims of a mass dispute file their claim individually. It will take much more time to assess all claims individually, also because the risk of irreconcilable judgment would have to be taken into account, than when the claims are compiled in one single procedure.

3.5.2 *Types of collective redress: model case, collective action and collective settlement*

As mentioned above, there are many types of collective redress mechanisms. Mechanisms can be public law- or civil law-oriented, based on opt-in or opt-out, using aggregate or representative techniques, and so on.[265] The aim of this thesis is not to give an overview on all types of collective redress mechanism available across the EU, therefore, only the three most common types of collective redress mechanisms will be discussed: (i) the model case procedure, (ii) the collective action, and (iii) the collective settlement.

The first type of collective redress mechanisms is the model case procedure. In this type of redress mechanism, one case is selected from a large amount of cases by a group of victims who have suffered damage caused by the same (or similar) event. The selected case serves as a model case for the resolution of all other individual disputes. The facts proven and answers given to various legal questions in the model case, will also apply in the other individual cases.[266] As the court needs to look at fewer matters in the remaining individual disputes, it is able to resolve the disputes more speedy. Also, given the example of the model case, there is more legal certainty/predictability for the parties involved as to the outcome of their individual dispute. An example of such a model case mechanism is the German KapMuG,[267] which has been specifically drafted to deal with mass disputes concerning financial services.

The second type of collective redress mechanism is the collective (or: class) action. Collective action is a mechanism whereby a collective claim is brought by a group of claimants that are established as a class or a foundation/association of victims. The court will deal with their claim collectively, as the

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[264] Opt-out mechanisms lead to a mass dispute being entirely resolved after the end of the period in which people can opt out of the court decision. Consequently, the victims can lay claim to the agreed compensation and, because they will no longer be able to file a similar claim individually, the defendant will not have to face future court proceedings. See paragraph 3.5.3.

[265] See for instance: European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829); T. Bosters, *Collective Redress and Private International Law in the EU* (Springer 2017).

[266] Ibid.

[267] Capital Market Model Proceedings Act (Kapitalanleger-Musterverfahrensgeset (KapMuG)) (Germany); Gesetzentwurf der Bundesregierung zum KapMuG, BT-Drucks, 15/5091

different claimants constitute one single group. The court therefore delivers one single judgement, which can apply to every individual victim, depending on whether the action is based on an opt-out or an opt-in systems and on how the action is further structured.[268] Well-known examples of such collective action mechanisms in the EU are the Dutch collective action,[269] the Swedish Group Proceeding[270] and the Danish[271] and Finnish class actions.[272]

The last mechanism for collective redress that will be discussed is the collective settlement. Collective settlement is comparable to collective action, as victims in a collective settlement are also organised in a representative group. In case of a collective settlement, however, the victims do not bring an action before the court, but they rather try to negotiate a settlement in which they are compensated for the damages they have sustained. The threat of collective action may be used as a means of coercion to reach a final settlement.[273] Depending on the system upon which it is based, the negotiated settlement may apply to all victims (opt-out system) or the victims that are formally part of the established group (opt-in system). The Dutch WCAM,[274] which has been applied in various disputes concerning financial services,[275] is an example of such a collective settlement mechanism.

3.5.3 *State of play: diversity of national mechanisms*

Given the many benefits collective redress can bring, it is notable that a number of Member States do not provide for (compensatory) collective redress tools at all.[276] Across the Member States that do have

[268] See T. Bosters, *Collective Redress and Private International Law in the EU* (Springer 2017).
[269] Article 3:305a of the Dutch Civil Code; Parliamentary Documents II, 1991–1992, 22486, nr. 3, p. 3, 5, 7, 22–23 (Dutch collective action). See: T. Bosters, 'Dutch Collective Action' in *Collective Redress and Private International Law in the EU* (Springer 2017).
[270] Group Proceedings Act (Sweden) SFS 2002:599; Government Bill 2001/02:107, Commissioners Report 2001/02:02:JuU16, Riksdag Communication 2001/02:246. See: P.G. Karlsgodt, *World class actions* (OUP 2012), p. 202 et seq.
[271] Section 245a-k of the Administration of Justice Act (Denmark); See Ibid., p. 186 et seq.
[272] Act on Class Actions (Finland) Ryhmäkannelaki (444/2007). Also see: Ibid., p. 214 et seq.
[273] T. Bosters, *Collective Redress and Private International Law in the EU* (Springer 2017), p. 14.
[274] Collective Settlement of Mass Damages Act 2005 (Wet Collectieve Afwikkeling Massaschade (WCAM)), laid down in Articles 7:907-7:910 of the Dutch Civil Code and 1013-1018 of the Dutch Code of Civil Procedure.
[275] See for example: Hof Amsterdam 25 januari 2007, JOR 2007, 71 m.nt. A.F.J.A. Leijten (*Dexia*); Hof Amsterdam 15 juli 2009, JOR 2009, 325 m.nt. A.C.W. Pijls (*Vedior*); Hof Amsterdam 29 mei 2009, JOR 2009, 197 m.nt. A.F.J.A. Leijten (*Shell*); Hof Amsterdam 12 november 2010, JOR 2011, 46 m.nt. J.S. Kortmann (*Converium I*); Hof Amsterdam 17 januari 2012, JOR 2012, 51 m.nt. B.J. de Jong (*Converium II*). For more information, see: I.N. Tzankova 'Funding of mass disputes: lessons from the Netherlands' (2012) 8 Journal of Law, Economics & Policy 549; Bosters et al., 'Voorontwerp afwikkeling massaschade in een collectieve actie' (2015) 24 Nederlands Juristenblad 1584; S. Marić , 'Wet collectieve afwikkeling massaschade, beleggingsschade, massaschade, class action, collectieve schikking' (2010) 9 Vennootschap & Onderneming 166.
[276] European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829), p. 15. "Among the twelve Member States selected for the purpose of this study, there are five Member States where no actual compensatory collective redress mechanism is provided for, three Member States in which it is only available in limited areas of the law and four Member States in which it is available in vast areas of the law or even regardless of the sector or issue at stake."

mechanisms that deal with mass investor claims, the systems differ considerably in relation to their scope, legal standing, opt-in/opt-out, funding and distribution of proceeds.[277]

A major difference between Member States is the form and scope of redress available. While in many states redress is not available at all, in the states where it is available, there may be differences in the type of claims that can be brought. In some Member States collective redress is only available for limited areas of law.[278] In others collective redress mechanisms may be available for relevant areas of law, but they do not offer the possibility for compensatory relief. In these systems where only declaratory relief can be obtained, often a two-stage approach is followed. First a declaratory judgement that a tort or contractual breach has been committed is collectively obtained, and second, on the basis of that judgment individual actions are to be brought to establish damages and causality. Even though in these systems the claimants cannot receive a judgement for monetary damages collectively, the ultimate goal of the declaratory judgements remains financial compensation. Nevertheless, the experts working on the EU study on collective redress,[279] were unanimous in concluding that mechanisms allowing for compensatory relief are necessary, as only this can ensure that the victims are fully compensated and provide a real deterrent effect for potential perpetrators.[280]

Other large differences are observed with regard to the technique used: opt-in or opt-out. The opt-in mechanisms obliges potential members of the group to expressly join the group: those who do not do so, are unable to avail themselves of the decision. On the contrary, under the opt-out mechanism all potential members of the group are presumed to have tacitly joined the group and will be able to avail themselves of the decision even if they did not ask for it, unless they expressly opted-out of the group. Currently the opt-in system is adopted by five Member States.[281] In only one Member State, the Netherlands, the opt-out system is adopted. In other Member States a mixed system may be available.[282] Generally the opt-in system is favoured by Member States, because it is conceived as more consistent with their legal and constitutional traditions, in particular the principle of party autonomy.[283] By contrast to an opt-out mechanism, an affirmative expression to opt in to the group is a very clear manifestation of consent. Nonetheless, studies have proven that people tend not to actively choose an option, even when they could.[284] Taking this into account, an opt-out solution seems to be a more powerful tool, as

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[277] O.O. Cherednychenko, 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403, p. 412.
[278] European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829), p. 18, giving the examples of Belgium, Italy and Spain.
[279] Ibid.
[280] Ibid., p. 20.
[281] Austria, France, Germany, Italy and Poland. Ibid., p. 23
[282] E.g. as in Belgium and the UK. Ibid., p. 25.
[283] Ibid., p. 23.
[284] Ibid., p. 23. See, by anology, statistic evidence in relation to donor opt-in and opt-out systems: L. Shepherd, R.E. O'Carroll and E. Ferguson, 'An international comparison of deceased and living organ donation/transplant rates in opt-in and opt-out systems: a panel study'(2014) 12 BMC Medicine 131; E.J. Johnson and D.G. Goldstein, 'Defaults and Donation Decisions' (2004) 78 Transplantation 1713.

it would overcome the rational apathy of victims and provide for a stronger deterrent effect.[285] Regardless the technique chosen, the problem remains with the discrepancies in the different European countries. The expert panel of the study on collective redress has emphasized that "*those discrepancies are very problematic (...) These divergences will potentially produce incentives for opportunistic behaviours as well as forum shopping. Issues related to the recognition of judgments applying a law favourable to collective redress and consumers will multiply within the EU. In an even more disquieting way, what will happen if a judge must recognise a decision although its own domestic legal system prohibits opt-out collective proceedings? In addition, these discrepancies will impede the development of a harmonized European instrument*".[286]

Legal standing, i.e. who can bring an action, also varies form one Member State to another. Some only grant standing to representative entities, others only enable members of the group to bring the action, while the rest authorizes both.[287] Where only representative entities are granted standing, differences also lie in the type of entities authorized to bring an action. "Qualified entities" can entail different persons across Member States: from affected class members to representative organisations to (consumer) ombudsmen. The question of legal standing is a sensitive issues; as a difficult balance must be struck: on the one hand, states want to limit the amount of persons eligible to bring claims so as to guarantee efficient safeguards against abuses; on the other hand, states should not be too restrictive in their criteria as to ensure sufficient access to justice.[288] Moreover, when selecting criteria entities will have to comply with before receiving legal standing, states will take account of how long the entity has been in existence, its purposes, the relation between the said purpose and the collective interest concerned and the (non-)profit character of the entity.[289] In states where the criteria are very strict, too few entities may be authorized to bring an action.

There are also divergences in relation to collective ADR. As already noted in the previous paragraph, there is throughout the Union a general tendency to shift from traditional court systems to alternative dispute resolution, *inter alia* for reasons of expediency and flexibility. The ADR Directive brought some improvements as to the availability and functioning of these mechanisms, however, the Directive itself does not provide for collective redress. As of today, there are only six Member States that have implemented a proper ADR system that allows resolution of mass disputes, or at least contain specific rules on ADR in the context of mass disputes.[290] Given the increasing popularity of the ADR disputes

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[285] I.N. Tzankova et al. 'Statement of the European Law Institute on Collective Redress and Competition Damages Claims' (European Law Institute 2014), p. 43.
[286] European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829), p. 27.
[287] Ibid., p. 27-31.
[288] This was also recognized by the Commission. European Commission, 'Report on the implementation of the Commission Recommendation of 11 June 2013 on common principles for injunctive and compensatory collective redress mechanisms in the Member States concerning violations of rights granted under Union law (2013/396/EU)' COM(2018) 40 final, p. 2.
[289] European Parliament 'Collective redress in the Member States of the European Union' (PE 608.829), p. 28.
[290] i.e Belgium, France, Italy, the Netherlands, Spain and the United Kingdom. Ibid., p. 38.

and the benefits it can bring to aggrieved parties, these mechanisms deserve to be developed and better adapted, so as to allow for collective resolution as well.

Another important divergence between Member States relates to the international dimension of the collective redress mechanisms. As European integration progresses further, cross-border cases are becoming more and more common. It has become crucial for the European Union to address multi-jurisdiction litigation. However, as regards collective redress, this hasn't been (properly) done. In some Member States the international dimension of collective redress has not been addressed at all,[291] in others it is only addressed to a limited extent, just on very precise matters (such as standing, joining the group or jurisdiction).[292] As the international dimension of collective redress is a crucial issue, it needs to be carefully dealt with at EU level. Important issues, such as the recognition and the enforcement, related to cross-border collective redress are currently insufficiently, or not at all, addressed by the Member States, nor by the EU (for instance in the Brussels I (Recast) Regulation).[293]

Further divergences are found *inter alia* with regard to publicity and availability of information on collective redress,[294] costs of proceedings,[295] and the possibility of third-party funding.[296] Also here the heterogeneity is considered problematic, as, eventually, European citizens are not awarded the same level of protection.[297]

All in all, there are still many shortcomings with regard to collective redress: compensatory redress is still not available in a number of Member States, legal standing is too restricted in some Member States, ADR mechanisms are not well adapted to collective redress, the international dimension of collective redress is insufficiently addressed and the many divergences between Member States' mechanisms cause uncertainty and inequality with regard to the accessibility to justice and the level of protection offered to aggrieved parties. Therefore, collective litigation and ADR in a lot of Member States are currently not able to sufficiently protect consumers and provide them with adequate measures to obtain redress.

3.6 EU Harmonization

The need for improving access to justice, including access to collective redress, has been repeatedly acknowledged on EU level.[298] In 2013 the Commission issued a recommendation on common principles

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291 E.g. Luxembourg, Poland, Romania, Estonia and Austria. Ibid., p. 39.
292 E.g. France, Belgium, the United-Kingdom, the Netherlands, Germany, Spain and Italy. Ibid., p. 40.
293 Ibid., p. 42.
294 Ibid., p. 31-33.
295 Ibid., p. 33-38.
296 Ibid., p. 35-36.
297 Ibid., p. 10, 15.
298 Pressure for consumer collective actions can be traced back to at least the 1980s. For an overview see: C. Hodges, 'Collective redress: A Breakthrough or a Damp Squib?' (2014) 37 Journal of Consumer Policy 67, p. 67-70.

for collective redress mechanisms concerning violations of rights granted under Union law,[299] and a communication on a horizontal framework for collective redress.[300] Especially the recommendation is interesting, as it invites Member States to establish domestic collective redress mechanisms and provides for a set of principles aimed at promoting a coherent horizontal approach throughout the EU. The recommendation addresses many issues in relation to collective redress, for example issues regarding the structure and organisational aspects of interest groups, legal standing, funding of the action and use of ADR. As the Recommendation is a soft law instrument, is does not directly harmonise the Member States' systems, nevertheless it explicitly recommends that "*all Member States should have collective redress systems at national level that follow the same basic principles throughout the Union, taking into account the legal traditions of the Member States and safeguarding against abuse*".[301] As such, it could be seen as a first step in the direction of regulation or harmonization of collective redress mechanisms in the EU.

In 2018, significant progress was made, as the Commission issued a proposal for a "New Deal for Consumers".[302] This New Deal includes a proposal for a Directive on representative actions for the protection of the collective interest consumers.[303] This proposal intends to improve tools for stopping illegal practices (injunctions) and to facilitate collective redress for consumers in mass harm situations. The Commission proposes a modernised system, based on representative actions. It would thus allow qualified (non-profit) entities, such as consumer organisations or independent public bodies, to defend collective consumer interests in mass disputes. The system will contain certain safeguards, such as limits to who can bring an action (entities wanting to bring a claim on behalf of a large group of consumers will have to fulfil certain criteria and must be transparent as to their sources of funding). In this way the Commission tries to maintain the earlier mentioned balance between access to justice and prevention of abuse.

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299 European Commission, 'Recommendation on common principles for collective redress mechanisms in the Member States for injunctions against violations of EU rights and claims for damages arising from these violations' COM (2013) 3539/3.

300 European Commission, 'Communication: Towards a European Horizontal Framework for Collective Redress' COM (2013) 401 final.

301 European Commission, 'Recommendation on common principles for collective redress mechanisms in the Member States for injunctions against violations of EU rights and claims for damages arising from these violations' COM (2013) 3539/3, recital 10.

302 European Commission, 'Communication: A New Deal for Consumers' COM(2018) 183 final; European Commission, 'Proposal for a Directive on representative actions for the protection of the collective interests of consumers, and repealing Directive 2009/22/EC' COM(2018) 184 final; European Commission, 'Proposal for a Directive amending Council Directive 93/13/EEC of 5 April 1993, Directive 98/6/EC of the European Parliament and of the Council, Directive 2005/29/EC of the European Parliament and of the Council and Directive 2011/83/EU of the European Parliament and of the Council as regards better enforcement and modernisation of EU consumer protection rules' COM(2018) 185 final.

303 European Commission, 'Proposal for a Directive on representative actions for the protection of the collective interests of consumers, and repealing Directive 2009/22/EC' COM(2018) 184 final.

The Proposal also addresses the instruments already existing on a EU basis: the ADR Directive and the ODR Regulation. The Commission proposes certain updates in order to make these existing frameworks more effective, for instance by promoting uptake by traders and establishing dialogues between the relevant actors. From April to July 2018, the Commission carried out a communication campaign in order to increase business engagement in ADR procedures and to raise awareness of the benefits of the ODR platform.[304] On 11 and 12 June 2018 the Commission also hosted an ADR Assembly, the objective of which was to bring together representatives of European ADR entities, ADR competent authorities, ODR contact points, European consumer centres, consumer organisations, business associations and other stakeholders and to provide a forum to exchange best practices and to discuss issues regarding the effective provision of alternative and online dispute resolution.[305] During the Assembly some positive aspects of the current framework were discussed, for instance, it was noted that the diversity of systems across the EU allows services providers to choose from a range of dispute resolution options and promotes competition in the sector, potentially leading to a higher overall standard. Also some challenges were identified, mainly relating to the diversity across the EU. Despite the possible advantages diversity may also lead to forum shopping (resulting potentially in legal uncertainty and problems regarding the finality of outcomes of dispute resolution), a poor public understanding of ADR (even experienced consumers or traders may be unaware or surprised by approached adopted in other systems) and variation in quality (potentially causing reputational damage to the entire ADR landscape). Next to these challenges, the ADR panel emphasized the need of still greater awareness and understanding. Consumers and traders need to be aware of, and trust, ADR. Domestic political support may contribute to this. Even with the awareness campaigns, there is still not enough knowledge (and trust) about some of the dispute resolution mechanisms.

All in all, this “New Deal for Consumers” ultimately aims at effective and timely access to justice for all EU citizens. It promotes accessible, high-quality and cost-effective dispute resolution in the context of increased risks of cross-border mass harm disputes due to the greater interconnected economies. In this way, it aims to protect consumers (including retail investors), increase confidence and foster prosperity and growth. Nevertheless, many challenges still lie ahead.

[304] European Commission, *EU Press release: Daily News* (06-12-2018) <http://europa.eu/rapid/press-release_MEX-18-6702_en.htm> accessed 20 April 2019.
[305] European Commission, *Summary report on the ADR Assembly 2018* <https://www.risolvionline.com/news.php?news_id=40&lng_id=14> accessed 20 April 2019.

Chapter 4: Public Redress

4.1 Introduction

As made clear in the previous chapters, it is axiomatic that redress should be paid whenever due. Too often however redress is either not paid, or is reduced by transactional costs or is delayed so long that the restorative effect is irrelevant.[306] The previous chapter has already shown that there are many drawbacks of and limits to private redress. Some of the obstacles identified could be overcome by means of ADR or collective litigation, but also these mechanisms are not flawless, and more importantly, not always available in many Member States. With the ADR Directive, the ODR Regulation and the recent Proposal for a new deal for consumers, the European Union has taken some steps in the right direction, aiming to improve private redress mechanisms. Nevertheless, these initiatives are not always efficient in achieving their objective: to effectively compensate aggrieved consumers, and so, ultimately protect and empower consumers.

Given the insufficient protection offered to consumers by and lack of access to compensation for consumers through private means, other, public, redress systems should be preferred. In fact, public redress mechanisms could significantly contribute to the ease and speed of obtaining redress whenever infringements occur. A mechanism that could be highly efficient in obtaining these objectives is regulatory redress, which is redress that is ordered or brought about by the intervention of public enforcers. Its strength is the combined weight of regulatory tools (such as administrative fines, alteration of license permits, etc.) and compensatory tools. The advantage is that both public and private aspects can be resolved in one process, thereby avoiding sequential procedures and costs. Currently regulatory redress mechanisms are rare, but two success stories can serve as an example: the general regulatory redress powers of the United Kingdom's Financial Conduct Authority (FCA) and the singular settlement between the Belgian Financial Services and Market Authority (FSMA) and the bank BNP Paribas Fortis.

4.2. Failure of collective litigation and the Commission's "New Deal" Proposal

In situations where mass damages has occurred, collective litigation aims to deliver redress swiftly and at proportionate cost so as to provide full compensation and rectification of the market balance. Even though aggregation of multiple individual private claims into one single civil procedure indeed contributes to lowering the cost-benefit threshold at which litigation is viable (and thus increasing efficiency and access to justice),[307] civil collective procedures are still considered to be "*too complex,*

[306] Hodges C., 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59.
[307] S. Voet, '"Where the wild things are": reflections on the state and future of European collective redress' in M. Loos and A. Keirse, *Waves in contract and liability law in three decades of ius commune* (Intersentia 2017).

costly and lengthy to fully reach its objectives".[308] Empirical evidence shows that a number of collective cases were dismissed at initial judicial scrutiny as they failed to satisfy the criteria for legal standing.[309] In many jurisdiction collective litigations takes years,[310] and it is only possible with significant funding, which is generally unavailable (or makes aggrieved parties reliant on lawyers and/or third party funders, which is also not desirable for various reasons).[311] As a result, the total number of collective litigation actions in Europe remains low. Even though there are some success stories, in practice, many mass disputes are not raised in litigation and even less are resolved.[312]

Whereas the current Commission proposals focus on the issue of balancing access to justice with the risk of abuse,[313] the actual problem relates to the confidence of aggrieved parties in the rule of law.[314] The costs and funding issues are considered intimidating and success is uncertain and may be only achieved after a substantial amount of time. The conclusion that could be drawn is that private collective litigation, especially if restricted to a limited pool of initiators, is not able to respond to the aggrieved parties' needs to obtain compensation swiftly and at proportionate costs. Unfortunately, such outcomes are (according to some scholars) "highly unlikely" to be achieved with the current Commission proposal,[315] which aims to establish a representative litigation mechanism. In fact, this litigation-based class or representative action is, according to some authors 'old technology'.[316] Other, newer, technologies could be more efficient and effective in delivering redress. Amongst those newer techniques,[317] is the mechanism of regulatory redress. In this system, regulatory authorities intervene and stimulate, agree or order redress to be paid.

[308] European Commission, 'Inception Impact Assessment, A new deal for consumers—revision of the Injunctions Directive' Ares(2017)5324969. Also see: United Nations Conference on Trade and Development (UNCTAD), *Manual on consumer protection* (2017); C. Hodges and S. Voet, *Delivering collective redress: new technologies* (Hart Publishing 2018), p. 43–152.
[309] It appears that despite heroic activism by lawyers in Italy and Poland in bringing class actions under new legislation, around half are dismissed on certification. C. Hodges and S. Voet, *Delivering collective redress: new technologies* (Hart Publishing 2018), ch. 3; US Chamber Institute for Legal Reform, *The growth of collective redress in the EU: In a survey of developments in 10 Member States* (2017).
[310] A striking example is the Deutsche Telekom case that spawned the KapMuG in Germany, which continues after 18 years (now in appeal before the Federal Supreme Court). C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59, p. 62.
[311] Reliance on private funders has a number of consequences, including selection of cases that have a high chance of success and likelihood of delivering large profits for the funders.
[312] C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59, p. 62.
[313] See para 3.5 and 3.6 of this thesis.
[314] C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59, p. 61.
[315] This is *inter alia* argued by Hodges. Ibid., p. 87
[316] Ibid.
[317] For an overview of more new technologies, see Ibid.

In a research on collective redress in the EU,[318] different types of mechanisms, including the 'newer' types such as regulatory redress, were evaluated based on criteria such as their speed, costs and ability to deliver effective outcomes. The empirical data showed that the new technologies scored much better on all these factors than the old ones. The new technologies were proven to be more flexible and able to better adapt to parties' needs. For instance, the research showed that the new technologies had more functions; not only can they obtain resolution of a dispute or delivery of redress, but they can also provide information and assistance to aggrieved parties (e.g. to address the root causes of complaints against the infringer and hence reduce future infringements and risks). Based on this evidence some conclude that the Commission's current proposals are unlikely to deliver effective collective redress for consumers,[319] or at least, are not best-suited to achieve that goal. In the words of Hodges: "*The proposed method is out of date technology, and other mechanisms are clearly preferable and should be adopted instead*."[320]

4.3 Regulatory redress[321]

One (and probably the most relevant) example of such a new technology is regulatory redress. Regulatory redress can be defined as a technique by which public authorities, being responsible for the enforcement of (consumer or sectoral) regulatory law use the existence of mass redress powers "*to negotiate swift payment of redress as an integral part of agreement with traders on the resolution of all legal consequences of legal infringement*".[322] If those powers are designated and operated in particular ways, the public authorities can deliver mass redress exceedingly swiftly and cheaply. Experience has proven that certain public authorities have actually been able to deliver mass redress in an effective, quick and cheap way. A very well-known example, which has been successful in obtaining mass redress for infringements relating to financial services, is the system developed in the UK (see below).

The effectiveness of regulatory redress mechanisms strongly depends on their general structure and design. In particular, there are three essential aspects that such mechanisms should embody in order to work successfully: (i) delivery of mass redress powers should be a function of enforcement; (ii) public

[318] US Chamber Institute for Legal Reform, *The growth of collective redress in the EU: In a survey of developments in 10 Member States* (2017); C. Hodges and S. Voet, *Delivering collective redress: new technologies* (Hart Publishing 2018).
[319] C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59.
[320] Ibid. He also has other critiques, which were already briefly addressed in Chapter 3 of this thesis: "[under the proposed system] Member States are permitted to maintain existing collective redress mechanisms. That will lead to considerable confusion and diversity, which does not support an integrated single market. Further, the proposal will lead to a diversity of available mechanisms between Member States and hence confusion and competition between intermediaries—forum shopping."
[321] Although there are many types and variations of (both old and new) redress mechanisms, given the scope of this paper, only one type of mechanism shall be addressed: regulatory redress.
[322] C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 833.

enforcers must adopt an approach to enforcement that envisages the deployment of mass redress powers; and (iii) public enforcers should have an 'integrated toolbox' approach to enforcement.[323]

4.3.1 *Redress as enforcement policy*

In order to enable regulatory redress in mass investment disputes, financial market supervisors should have within their enforcement powers the power to deliver mass redress. Although redress power is often not included in the traditional enforcement powers of financial supervisors, it would fit well in relation to their functions and aims. In general, one of the core purposes of regulatory enforcement is to ensure a balanced and competitive market. This necessarily implicates a responsibility for ensuring that, whenever a market becomes unbalanced as a result of illegality (for instance due to provision of misleading or lack of information of the risks involved with certain investments or failure to warn clients for inappropriate or unsuitable products), the balance is restored. The classical approach to enforcement of law is to go at the offender. Typical enforcement actions after a violation has occurred are aimed at prevention of further or future damages and/or 'punishing' the offender, through sanctions, prohibitions, orders, or removal of licenses. Victims have been traditionally ignored in such processes.[324] The rationale behind this seems to be that they can revert to civil-law to have their damages compensated. Nevertheless, as we have seen, private redress mechanisms are not always able to succeed in this task and can therefore not be considered a sufficient guarantee that redress is obtained.

A wider focus of the financial supervisor, also taking into account the interests of the aggrieved investors, should be promoted in order to enable them to deliver redress. For several reasons, redress powers should be part of the enforcement powers. First and foremost, redress could be effected by the supervisors in a highly efficient way, without leaving matters to the uncertainty of achievement by private actors and private intermediaries. Combining aspects of public and private enforcement can achieve economies and save expenditure on transactional costs. It is thus certainly more efficient to pursue both the objectives at the same time, in terms of time and costs as well as in terms of investor protection.[325] Also, softer enforcement, such as restorative justice, can contribute to the achievement of traditional aims such as prevention, punishment and deterrence.[326]

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[323] These three parameters are used by Hodges to assess the effectiveness of redress mechanisms. Ibid.
[324] Ibid., p. 837.
[325] This is also argued by Cherednychenko. O.O. Cherednychenko, 'Public and Private Enforcement of European Private Law in the Financial Services Sector' (2015) 23 European Review of Private Law 621, p. 640-641. Also see: A. Marcacci 'Private Enforcement' in *Regulating Investor Protection under EU Law* (Springer 2018), p. 295 et seq.
[326] C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 838; C. Hodges, *Law and Corporate Behaviour: Integrating Theories of Regulation, Enforcement, Compliance, Culture and Ethics* (Hart Publishing 2015).

4.3.2. *Sufficient powers and techniques to oversee that compensation is paid*

A second requirement for regulatory redress is that the regulator possess the techniques and powers to require and oversee that restitution or reparation be made by the natural or legal person to whom the infringement is attributed. This is a complex issue. There is wide range of options as to how a public body may achieve that an investment firms makes redress to aggrieved investors, extending from formal exercise of a state authority towards more informal persuasion. A more extensive list can be found in the works of Hodges,[327] but some of the possible techniques are the following:

Public enforcers, such as financial supervisors, could be given the power to order redress to be paid, identifying how much is to be paid to every possible claimant. This approach could be highly efficient and speedy, but it also has the obvious drawback that the competent authority needs to be aware of all the details, so it does not have the flexibility to cope with situations where the quantification of loss of each identifiable recipient is unknown.

Instead of identifying the compensation to be paid themselves, enforcers could also refer the assessment of loss to the court, after having established the infringement. In this option, the public authority would first establish an infringement, and then refer the aggrieved investors to the civil courts for the quantification of their damages (and thus for compensation). Instead of ignoring the issue of redress, the public authority in charge would now pass the responsibility to a court or another body (for instance an ADR body).

Another option would be that the public enforcer is given the power to order an infringer to create a restoration scheme, without specifying the detail of which individuals are to be paid how much and without further scrutiny. This may constitute an incentive or a threat for the infringer to act responsibly, nevertheless the disadvantage of this option is that without the power to order or approve the details of such a restoration scheme, it may simply be ignored. This problem could possibly be overcome if the authority could order that the compensation scheme would be approved by the authority itself, by a court or another independent body (for instance an ADR body). This technique is employed by the FCA in the United Kingdom, as discussed below.

To a lesser extent, enforcement authorities could also incentivize infringers to implement redress speedily (and voluntarily) by taking into account, when deciding on the imposition of a sanction, the payment of compensation made by a firm. This provides a financial incentive for investment firms to agree upon (voluntary) redress payments, as it could lead to a reduction in the level of the public penalty.

These, and other options as to how power and approaches towards regulatory redress may be designed, have their strengths and weaknesses. The effectiveness of these techniques is enhanced where several

[327] See e.g. C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829.

of the powers are combined. Effectiveness and flexibility could be best achieved where the power of the public enforcers would encompass the following three elements: the power to order redress or to seek a court order for redress, the power to approve the fairness of a proposal to make redress and the power to reduce a penalty where redress is paid. Individually and together these three elements incentive and facilitate the outcome of redress.

4.3.3 *An 'integrated toolbox' approach*

The third parameter for effective regulatory redress has two components: the first one is the ability of an enforcer to deploy compensatory redress tools together with all other public (regulatory, administrative enforcement and sanctioning) tools. And the second one is the enforcer's ability to negotiate settlement of all regulatory, administrative, civil and redress facets of a case at once as part of one comprehensive agreement.

The combined weight of the various enforcement tools renders the enforcer's redress power particularly effective.[328] The threat of the use of (additional) alternative powers, such as administrative fines, public warnings and amendment or removal of licenses, makes that infringers will take the order for redress more seriously. The force being applied by the financial supervisor can be considerably stronger than the mere threat or a civil judgement to pay money resulting from litigation.[329]

Naturally, in order to benefit from the combined strength of tools, the enforcer will need to be able to settle all facets of a case in one comprehensive agreement. Such holistic resolution is not only more effective, it is also more efficient as it can save a lot of time and costs by reducing, or even avoiding, (public expenditure on) litigation. It will obviously be beneficial for investors and investment firms as well[330] when the dispute will be resolved more swiftly and cheaply when both the public and the private aspects are dealt with contemporaneously.

4.4 The need for an explicit legal basis? Examples of regulatory redress in the UK and Belgium

Once the three requirements as discussed in the previous paragraph are present, redress can be achieved with remarkable speed and at very low (transactional) cost.[331] Practical evidence of this is given by the success of the FCA redress powers in the UK. At the moment, the FCA is the only financial supervisor that is explicitly granted the power to order redress. Nevertheless, regulatory redress has also been achieved by other superiors, without such explicit legal basis. An example where regulatory redress was

[328] C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59, p.63.
[329] C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 857.
[330] Not only because of the costs and time involved in litigation, but also since this would reduce or avoid ongoing damage to investors and damages to reputation and saving costs for investment firms.
[331] C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 836.

ordered by a supervisor, without that supervisor being explicitly enabled (or charged with the task) to do so, is the BNP-Paribas Fortis settlement by the Belgian FSMA. Both examples will be briefly discussed below.

4.4.1 *The Financial Conduct Authority (UK)*

A widening of the functions of supervisors beyond the more 'traditional' enforcement functions to include "*rectification of unbalanced markets*",[332] and thereby to redress aggrieved parties' losses, has occurred as part of the development of the UK policy on Better Regulation.[333] In 2004-2008, the UK government re-examined the system of regulatory sanctions, with a view to "*promote more efficient approaches to regulatory inspection and enforcement while continuing to deliver excellent regulatory outcomes*".[334] In this review, a lot of attention was paid to increasing the efficiency of regulatory policy, *inter alia* by combing techniques of market rectification and redress for victims. Pivotal in this evolution was the Macrory Review.[335] In 2005, professor Macrory was asked to review regulatory enforcement penalties. In his review, he developed a set of six "Penalty Principles" that should underlie a modern regulatory sanctioning system. Amongst these six principles were the principle that financial gain or benefit from harm should be eliminated[336] and that the harm caused by regulatory non-compliance should be restored.[337] All major UK regulatory authorities, including the financial supervisor, have been required to issue enforcement policies that conform to and take account of these principles.[338] Specifically, the Regulatory Enforcement and Sanctions Act 2008 (RESA) gave regulators the possibility to apply for extended power to impose civil sanctions, including fixed or variable monetary penalties, compliance notices, stop notices, enforcement undertakings, and restorations notices (requiring the offender to take steps to put right any damage caused as a result of the non-compliance and address any harm).[339] A 2015 recodification of enforcement powers has extended policy and powers on securing redress, giving enforces, including the FCA, extensive powers and discretion to order compensation or other redress to aggrieve parties that have suffered loss.[340]

[332] Ibid., p. 840.
[333] S. Weatherill, *Better Regulation* (Hart Publishing 2007); P. Hampton, *Reducing Administrative Burdens: Effective Inspection and Enforcement* (HM Treasury 2005).
[334] *Implementing Hampton: from enforcement to compliance* (HM Treasury 2006).
[335] R. Macrory, *Regulatory Justice: Making Sanctions Effective* (HM Treasury 2006).
[336] Second principle. Ibid. p, 10, 29.
[337] Fifth principle. Ibid. p, 10, 31.
[338] Regulatory Enforcement and Sanctions Act 2008 (UK); Legislative and Regulatory Reform Act 2006 (UK); Regulators' Code (UK).
[339] Regulatory Enforcement and Sanctions Act 2008 (UK). Also see: S. Voet, '"Where the wild things are": reflections on the state and future of European collective redress' in M. Loos and A. Keirse, *Waves in contract and liability law in three decades of ius commune* (Intersentia 2017). *Nota bene*: The FCA decided not to apply for civil sanction powers under RESA since it concluded that having them would not make a material difference to the effectiveness of its enforcement action. See: C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829.
[340] Consumer Rights Act 2015 (UK).

In line with the Macrory principles, all British (sectoral) regulators have within their enforcement policy the objectives to compensate victims and to remove financial gain,[341] however, their approaches to delivering redress vary. In the case of the FCA, the enforcement policy explicitly includes "*holding firms to account for misconduct and requiring them to make good on the losses they cause consumers*".[342] To achieve this objective, the FCA has a sequence of redress powers that support voluntary initiatives of investment firms to deliver collective redress,[343] such as the power to provide the FCA with complaints handling data and the power to require them to appoint an "approved person" with official responsibility for oversight of the firm's compliance with complaints handling rules.[344] Next to that, in cases of market abuse, the FCA can apply to the civil courts for a Restitution Order[345] or make such an Order itself, where it finds that an authorised person has infringed a relevant requirement or was knowingly concerned in the infringements of such a requirement, and either profits have accrued to him as a result of the infringement (financial gain) or one or more persons have suffered loss or have been otherwise adversely affected as a result of the infringement.[346]

More generally, for infringement by firms of the requirements applicable to them in relation to the carrying on by them of any activity, such as infringement of the conduct of business rules, the FCA has two procedures for putting in place procedures for handling mass claims: they can require firms to establish and operate either a consumer redress scheme[347] (applicable to multiple firms) or a single firm scheme.[348]

A consumer redress scheme may be ordered where it appears to the FCA that there may have been a widespread or regular failure by investment firms to comply with requirements applicable to them, and, as a result, consumers have suffered loss or damage in respect of which, if they brought legal proceedings, a remedy or relief would be available.[349] Under a consumer redress scheme, as well as under a single firm scheme,[350] the FCA can require firms to take one or more of the following steps: investigate whether the firm has failed to comply with particular requirements that are applicable to the activity it has been carrying on; determine whether the failure has caused, or may cause, loss or damage

[341] For the FCA, see: Financial Conduct Authority (FCA), *Dispute Resolution: Complaint* (Sourcebook), Ch. para. 5.40.
[342] Financial Conduct Authority (FCA), *Approach to Regulation* (2011), para. 1.1. The instances cited included personal pensions, mortgage endowment policies, split capital investment trusts, and PPI. "*Millions of consumers have suffered detriment on a large-scale and, together, the industry has had to make compensation payments of approximately £15 billion, with most PPI redress still to come. Such outcomes would be regarded as unacceptable in other sectors of the economy*."
[343] See Financial Ombudsman Service (FOS) and Financial Services Authority (FCA), *Consumer complaints: The ombudsman award limit and changes to complaints-handling rules* (Consultation Paper, CP11/10).
[344] Ibid., para. 1.3.7 R.
[345] Financial Services and Markets Act 2000 (UK), section 383.
[346] Ibid., section 384.
[347] Ibid., section 404.
[348] Ibid., section 404F(7).
[349] These conditions are specified under: Ibid., section 404(1).
[350] Ibid., section 404F(7).

to consumers, and/or; determine what the redress should be in respect of the failure and make the redress to the consumers. The initial complaint handling and repayment is to be undertaken (voluntarily) by the relevant firm(s). If, however, a consumer is dissatisfied with the determination made by a firm under its consumer redress scheme or if it considers that a firm has failed to make a determination in accordance with the consumer redress scheme, it can make a complaint to the FOS.[351] The FOS will then decide whether the firm should take (or should have taken) particular action in relation to the consumer, such as a money award to the consumer, and may direct the firm to take that action.[352] Compliance which such a direction of the FOS is enforceable by the courts.[353] In addition, a single firm scheme can also be effected by the FCA by altering a firms' permission or authorization to operate.[354] The threat of the taking of such measures by the FCA can incentivize a firm to effect a redress scheme. In practice, the removal or alteration of the terms and conditions of a licence has been highly effective in giving enforcers leverage to insist that redress is paid.[355]

4.4.2 *BNP Paribas Fortis settlement*

Another example of regulatory redress is the settlement between the Belgian financial supervisor, the FSMA, and the bank BNP Paribas Fortis. This settlement is certainly remarkable, as the FSMA in this case was not specifically granted the power to order compensation and/or reimbursement of aggrieved investors, but instead adopted a wide approach to its powers under Article 71(3) of the Act on the supervision of the financial sector and financial services of 2 Augustus 2002.[356] Under this Article, the FSMA is granted the power to approve a settlement with (*inter alia*) investment firms that have breached the rules aimed at investor protection, such as the conduct of business rules,[357] but there is no explicit guidance as to what this settlement may include.

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351 Ibid., section 404B.
352 Ibid., section 404B(8).
353 Ibid., section 404B(9).
354 Ibid., section 404F(7).
355 C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 846.
356 This Article states: "*Het directiecomité kan, voordat de grieven ter kennis worden gebracht, een minnelijke schikking aanvaarden voor zover de betrokken personen hebben meegewerkt aan het onderzoek en zij voorafgaandelijk met die minnelijke schikking hebben ingestemd* (...)."
357 Article 45 of the Wet van 2 augustus 2002 states that the supervision and enforcement of compliance with these rules is one of the functions and objectives of the FSMA: "*De FSMA heeft als opdracht, overeenkomstig deze wet en de bijzondere wetten die op haar van toepassing zijn : 1° toe te zien op de naleving van de regels die de bescherming van de belangen van de belegger beogen bij verrichtingen in financiële instrumenten en op de naleving van de regels die de goede werking, de integriteit en de transparantie van de markten voor financiële instrumenten moeten waarborgen en meer in het bijzonder op de regels bedoeld in hoofdstuk II [en de bepalingen van de wet van 21 november 2017 over de infrastructuren voor de markten voor financiële instrumenten en houdende omzetting van Richtlijn 2014/65/EU]* (…)."

In the FSMA settlement with BNP Paribas Fortis,[358] for the first time, an investment firm was not only ordered to pay an administrative fine (in this case BNP Paribas Fortis had to pay a fine of 700,000 euros), but was also required to reimburse aggrieved non-professional investors.[359] The reason for the settlement was the inadequate services provided by BNP Paribas Fortis concerning Greek government bonds vis-à-vis its non-professional investment clients.

In 2009 Greece had entered into a financial and economic crisis, in which the country lost confidence in financial markets and European institutions saw its debt position falter. Greece's creditworthiness score at the three largest rating agencies deteriorated rapidly from spring 2010. From March 2011, markets indicators and ratings indicated very high uncertainty regarding the Greek debt position.[360] Nevertheless, Greek government bonds still enjoyed a favourable score in the risk scoring model of BNP Paribas Fortis. In fact, BNP Paribas Fortis did not adjust its risk assessment until 24 November 2011. During this period, (non-professional) investors, regardless their risk profile, were able to purchase Greek government bonds from BNP Paribas Fortis via various investment services: at their own request via execution-only or mere order execution, but also through advisory management or investment advice and discretionary asset management. Only after 24 November 2011, Greek government bonds were considered to be high-risk products in the bank's model. At that time, the three largest credit rating agencies placed Greek government bonds in the category "*extremely speculative, imminent default and little prospect for recovery*".[361] Nevertheless, after this date, risk-taking investors could still buy these bonds (on advice of the bank), against the bank's internal advice codes.

In light of this information, the FSMA considered that, at least with regard to investors who have purchased Greek government bonds after 30 March 2011 under investment advice or discretionary asset management, BNP Paribas Fortis services were not in line with its obligations under the conduct of business rules, including those relating to the suitability assessment. In the settlement publication, the FSMA notes that the inherent risks associated with Greece and its government bonds, as determined by the information available on credit ratings and market indicators, did not match the investment profiles

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[358] Financial Services and Market Authority (FSMA), *Minnelijke schikking gefpoormuleerd door de auditeur van de FSMA en waarmee BNP Paribas Fortis NV heeft ingestemd* (28 maart 2017). Retrievable via <https://www.fsma.be/nl> accessed 26 April 2019.

[359] The settlement of 700,000 euros was also one of the highest ever imposed by the FSMA, and it was the first time in Belgium that an administrative sanction has been imposed for a breach of the MIFID investment directive. See: 'BNP Paribas Fortis beboet voor verkoop van Griekse obligaties' De Standaard (31 March 2017) <http://www.standaard.be/cnt/dmf20170330_02809610> accessed 26 April 2019; 'BNP Paribas Fortis krijgt boete voor verkoop risicovol Grieks schuldpapier' Trends (30 March 2017) <https://trends.knack.be/economie/bedrijven/bnp-paribas-fortis-krijgt-boete-voor-verkoop-risicovol-grieks-schuldpapier/article-normal-834659.html> accessed 26 April 2019.

[360] For instance, at the end of March 2011, credit rating agency S&P lowered the rating of Greece significantly, pointing to very high uncertainty about the Greek debt position. Before that, on 7 March 2011, credit rating agency Moody's had already lowered its rating, considering its quality "highly speculative". See: Trading Economics <https://tradingeconomics.com/greece/rating> accessed 26 April 2019.

[361] The ratings at that time were as follows: S&P: CC; Moody's: Ca; Fitch: CCC. See: Trading Economics <https://tradingeconomics.com/greece/rating> accessed 26 April 2019.

of the investors to whom these government bonds were sold.[362] The FSMA also noted that, after the write-down of Greece by S&P on March 29 2011 (given the financial-economic and political context including market indicators of Greece) an investment in Greek government bonds was no longer in line with the investment objectives of investors with a conservative, defensive and neutral investor profiles.[363] When on 21 July 2011, through a voluntary debt rescheduling proposal by Greek creditors, it became clear that Greek government bonds entailed a *de facto* high loss risk, the FSMA considered that an investment in Greek government bonds also was no longer in line with the investment objectives of investors with a dynamic and aggressive investor profile.

The FSMA established that in that period a total of 67 purchase transactions for a total transaction value of 6,013,619 euros were made, of which arguably 24 transactions for a total amount of 2,488,605, euros were in line with the objectives of the investors concerned. Under the terms of settlement, BNP Paribas Fortis had to fully compensate the loss suffered by all investors who had purchased Greek government bonds based on the bank's investment advice or discretionary asset management in the period from 30 March 2011 to 23 November 2011 (for investors with a conservative, defensive or neutral investor profile), in the period from 21 July 2011 to 23 November 2011 (for investors with a dynamic or aggressive investor profile) or in the period after 24 November 2011 (for investors who had purchased Greek government bonds against the bank's internal advice codes).[364] Under the condition that this compensation was made, the FSMA imposed an administrative fine of 700,000 euros.

It is remarkable that the financial supervisor in this case was able to order redress to aggrieved investors without an explicit legal basis to do so under national law. This case proves that even though the explicit legal powers lack, effective redress can still be achieved as long as some conditions are present:[365] the delivery of mass redress is to be considered a function of enforcement (and thus part of the enforcement policy), an approach that envisaged the deployment of mass redress is to be adopted and an 'integrated toolbox' approach to enforcement must be developed.

4.5 EU harmonization

From the examples of the FCA and the FSMA, it is shown that regulatory redress can be an effective mechanism in obtaining investor redress, and therefore in serving investors interests and restoring the market balance when infringements occur. Nevertheless, these two examples are quite unique. In the

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[362] Financial Services and Market Authority (FSMA), *Minnelijke schikking geformuleerd door de auditeur van de FSMA en waarmee BNP Paribas Fortis NV heeft ingestemd* (28 maart 2017), para 25.
[363] Ibid.
[364] Ibid., p.10.
[365] In fact, the FSMA has employed its powers in a way to order remedial action in other circumstances as well. A comparable case is related to 'Bermudan swaps'. The FSMA has in this case requested four banks, that had not complied with its conduct of business requirements for the provision of services connected to 'Bermudan swaps' in relation unprofessional investors, to replace the 'Bermudan swaps' by a 'plain vanilla swap' (a less complex swap) without costs to the investor. See: Financial Services and Markets Authority (FSMA), *Rentederivaten ter dekking van aan kmo's verleende kredieten met variabele rentevoet* (Mei 2015).

majority of Member State there is no system for (or precedent of) regulatory redress. Given the lack of regulatory redress mechanisms and the substantial weaknesses and drawbacks of alternatives (such as private litigation, including collective litigation, and ADR as established under the ADR Directive), investors are put in jeopardy, as they are unable to obtain compensation for the loss they may suffer or have suffered due to infringement of the conduct of business rules. Harmonization of regulatory redress powers (as will be developed below) could provide a solution. Nevertheless the EU has hitherto been inhibited form harmonizing such public enforcement powers, because of a lack of jurisdiction under the Treaties and the application of the principle of subsidiarity.[366] As a result, MiFID II only stipulates that Member States shall ensure that their competent authorities may adopt sanctions and measures that are "dissuasive, proportionate and effective", without giving much guidance on how the dissuasiveness, proportionality and effectiveness should be measured and achieved.[367]

The extensive harmonization of rules on substantive law regarding financial markets and services, such as the conduct of business rules, is in sharp contrast with the lack of harmonization with regard to the enforcement of this substantive law across the Union. To ensure consistent application of the (investor protection) rules, there should be a level playing field when it comes to enforcement. As this thesis has demonstrated that there are still many gaps and differences between Member States with regard to enforcement and the possibilities for investors to obtain redress. As the Commission has stated before: "*In certain sectors, such as financial services, transport, telecommunications and energy, regulators play an important role in market surveillance. It should be noted though that these mechanisms often do not foresee compensation for harm suffered by consumers.*"[368] This comment highlights the extent to which the EU architecture relies on public enforcers as well as the need for coordinated enforcement and the need to include redress as part of enforcers' functions and powers.[369] The traditional paradigm that a public enforcer would only prosecute traders for a breach, is outdated. Nowadays, regulators increasingly aim to achieve a wider range of outputs, such prevention of breaches, including prevention of reoccurrence, and delivering redress to those harmed and so restoring the markets to its "level playing field" position.[370] A fair, competitive market should not be distorted by the effects of illegal actions by

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366 C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 868.

367 See: Article 70 MiFID II.

368 European Commission, 'Impact assessment accompanying the document Proposal for a Directive of the European Parliament and of the Council on Alternative Dispute Resolution for consumer disputes (Directive on consumer ADR) and Proposal for a Regulation of the European Parliament and of the Council on Online Dispute Resolution for consumer disputes (Regulation on consumer ODR)' COM(2011) 793 final, p. 14.

369 C. Hodges, 'Mass Collective Redress: Consumer ADR and Regulatory Techniques' (2015) 5 European Review of Private Law 829, p. 869. *Nota bene*, as earlier discussed, the question for this need was also included in the Commission's Public Consultation on Review of the Consumer Protection Cooperation Regulation. See paragraph 3.2.

370 C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59, p. 63; C. Hodges, 'A Market Based Competition Enforcement Policy' (2011) 22 European Business Law Review 261, p 261. This is also demonstrated by the examples of the FCA and the FSMA given in the previous section.

financial actors. It should be the responsibility of financial supervisors to ensure that, when infringements occur, the market balance is restored and, thus, that redress is paid to those that have suffered losses and that illicit gains are not retained by infringers.[371]

Given the many benefits of regulatory redress, it would be desirable to promote this on a European level. In this way, investors across the Union would have the same, or at least an equitable, level of protection and access to redress. The promotion on European level, could take several forms. For purposes of legal certainty and predictability, it would be desirable to regulate that ordering redress and restoring market balance is one of the functions and powers of financial supervisors. Such regulation could take an example of the Consumer Protection Cooperation (CPC) Regulation,[372] in the area of European consumer law, which harmonizes a set of minimum powers for all consumer law enforcement authorities, including the power to seek to obtain remedial commitments from traders for the benefit of affected consumers (*nota bene*, it is thus not a direct power to order redress, whether remedial commitments will be made, still depends on the traders willingness to do so).[373] Such remedial commitments may include, for example, repair, replacement, priced reductions, the termination of contract or the reimbursement of the price paid for the goods, and is without prejudice to a consumer's right to seek redress through other appropriate means.[374] This Regulation only applies to the infringements of the Directives and Regulations listed in its Annex. It is (currently) not applicable to authorities responsible for the enforcement of MiFID II and MiFIR, and does therefore not give them the power to seek to obtain redress in situations where retail investors have suffered losses due to violations of the conduct of business rules. The minimum powers of these financial supervisors, responsible for the enforcement of *inter alia* the conduct of business rules, are in fact listed in Article 69 of MiFID II. As we have seen before, they do not include any reference to redress powers. Nevertheless, the regulation of harmonized regulatory redress powers could be achieved by an extension of the powers in Article 69 of MiFID, so as to include powers comparable to those attributed to consumer law enforcement authorities under the CPC Regulation.

However, it remains questionable whether such a direct regulation of regulatory redress powers would be conceived well by the European Member States. In the Public Consultation on the review of MiFID,[375] many respondents, showed their unwillingness to introduce a European ground for civil

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[371] C. Hodges, 'Collective Redress: The Need for New Technologies' (2019) 42 Journal of Consumer Policy 59.
[372] Regulation (EU) 2017/2394 of the European Parliament and of the Council of 12 December 2017 on cooperation between national authorities responsible for the enforcement of consumer protection laws and repealing Regulation (EC) No 2006/2004. The Regulation will be applicable from 17 January 2020 on.
[373] Article 9(4)(c) of Regulation (EU) 2017/2394.
[374] Ibid., recital 17. "*Where applicable, competent authorities should inform, by appropriate means, consumers that claim that they have suffered harm as a consequence of an infringement covered by this Regulation about how to seek compensation under national law*." This power is also harmonized under Article 9(4)(d) of the Regulation.
[375] European Commission, Director General Internal Market and Services, *Public consultation: review of the markets in financial instruments directive (MiFID)* (2010), p. 63 et seq. Also see: D. Busch, 'MiFID II:

liability for infringements of MiFID provisions, pointing to the principle of subsidiarity. Likewise, it can be expected that a European ground for regulatory redress powers may by some Member States be considered intrusive of national sovereignty. This is all the more so given the current political framework, which generally shows an adverse position towards (ever-)increasing European harmonization.[376] Other, less 'intrusive' ways of harmonization may therefore be more feasible. For example, ESMA could, in its Opinions or Guidelines, pay (more) attention to the objectives of financial supervisors to restore market balance where (conduct of business) infringements occur and suggest and promote the use of regulatory redress powers. Alternatively, the examples of the FCA and the FSMA could be used and promoted as a best practice, stimulating other financial supervisors to pay more attention to the interests of aggrieved investors and to use the powers given to them under national law more creatively. Even though this does not directly create a legal basis for financial supervisors to order redress, it can contribute to the acceptance of such powers and, ultimately, help to create a stronger framework for investor protection by improving their access to redress.

Europese aansprakelijkheid van beleggingsondernemingen?' (2011) 13 Tijdschrift voor Financieel Recht 57, p. 57-58. D. Busch, 'Drie fundamentele vragen voor de Europese Commissie', (2010) 59 Ondernemingsrecht 294, p. 294-295.

[376] As is demonstrated by the fact that the UK is leaving the EU as well as the increasing popularity of Eurosceptic political parties in numerous EU Member State. See for instance: L. Martin-Estudillo, *The Rise of Euroskepticism: Europe and its Critics in Spanish Culture* (Vanderbilt University Press 2018); S. Usherwood and N. Startin, 'Euroscepticism as a Persistent Phenomenon' (2013) 51 Journal of Common Market Studies 1; R.J. Pohoryles, 'How to cope with the rise of populism in Europe' (2019) 32 Innovation: the European Journal of Social Science Research 165.

Conclusion:

Financial markets, in particular investment services, have become an essential part of the everyday life of EU citizens. Such services facilitate citizens' full participation in the economy, enabling them to plan for the long term and to invest in financial products to build up money for the future. Financial markets are also of great significance for the EU economy. Financial markets can provide finance for companies, so they can hire, invest and grow, and enable banks to borrow money, helping them to make loans to people wishing to borrow. This way, financial markets help to efficiently direct the flow of savings and investment in the economy in ways that facilitate the accumulation of capital and the production of goods and services. A single market in financial services, which has been the overall objective of EU regulation in this field, would therefore "*act as a catalyst for economic growth across all sectors of the economy, boost productivity and provide lower cost and better quality financial products for consumers and enterprises*".[377]

To facilitate the free flow of capital and to contribute to the development of a single market in financial services, the ISD in 1993 introduced a 'European passport' for investment firms to offer their investment services within the EU based on a licence granted by the home regulator. By virtue of this European passport, banks, investment firms and other financial actors covered by the regulatory framework are allowed to do business throughout the EU without the burden of complying with local regulatory requirements. Even though, this European passport greatly facilitates cross-border investment services in Europe, it also poses many risks, especially for unprofessional investors. Investors, and in particular retail investors, need to be protected against information asymmetry and conflicts of interests between them and the investment service providers. MiFID II aims to offer such protection, by regulating the relationship between investment firms and their clients.

The MiFID rules, and especially the conduct of business rules, form a thick layer of EU requirements applicable to investment firms when providing investment services or performing investment activities in the European Union. These requirements are mainly based on three overarching principles: (1) the principle of loyalty, pursuant to which investment firms must act honestly, fairly and professionally in the best interest of its clients, (2) the informed consent principle, according to which the investment firm must adequately disclose to their clients relevant material information, which is fair clear and not misleading, and (3) the know-your-customer principle, by which investment firm must provide services that take account of the individual circumstances of the client, including their knowledge and experience in the investment field, their financial situation and their investment objectives. The amount of protection investors enjoy under these 'conduct of business' rules depends on their professionality

[377] Economic and Financial Committee (EFC), *Report by the Economic and Financial Committee on EU financial integration* (ECFIN/194/02). Also see: Cherednychenko O.O., 'The Regulation of Retail Investment Services in the EU: Towards the Improvement of Investor Rights?' (2010) 33 Journal of Consumer Policy 403.

(retail investors deserve more protection than professional investors or eligible counterparties) and the type of services requested (when they request execution-only services investors are awarded less protection than when they request investment advice or portfolio management). This thesis has focused on the needs of retail investors, which require substantial protection because they may not always be able to read, absorb or correctly process the available information, and because they are for a large part dependent on financial intermediaries, which may not always act in the best interest of their clients. MiFID deals with these problems and provides an extensive, harmonized framework of prudential rules and rules of conduct for investment firms which should ensure a high level of investor protection and contribute to investor trust in financial markets.

Despite the extensive regulatory framework (even after the updates after the financial crisis), mis-sellings, whereby investors end up with products that are not optimal, suitable or appropriate for them, continue to occur. The amount of damage that investors in these cases can incur is tremendous. In many circumstances mis-sellings can be prevented, or at least reduced, when effective enforcement is in place. Nevertheless, even after the experiences from the financial crisis, the conclusions by the De Larosiere Report and the adaptations of the European enforcement system, fragmentation of supervision and enforcement in Member States persists. In addition, many supervisory authorities, both on a national and a European level, seem to still lack the powers, capacity or willingness to timely intervene and stop violations. As a consequence, many MiFID violations continue unabated.

It is axiomatic that, where (*ex ante*) supervision fails and violations of the conduct of business principles result in mis-sellings, investors should have right to remedies. One of the main purposes of the EU investor protection regime is to empower investors to make adequate use of their rights. The prevailing assumption that the empowered investor can, actually, make adequate use of its rights depends in part on the assumption that effective and accessible redress mechanisms are available. Likewise, regulatory effectiveness depends on this assumption. Efforts to encourage firms to uphold high levels of investor protection are incomplete when firms are not sufficiently incentivized, in terms of litigation and reputational risks, by the threat of investor action.

Moreover, the existence of effective redress systems is also linked to the amount of cross-border activity and confidence in the financial market. As the Commission remarks in its Consumer Agenda, if consumers were to have confidence in the internal market, they need to have confidence in effective and efficient enforcement of their rights and the availability of speedy and cost-effective redress and supported ADR mechanisms. Effective redress mechanisms are thus key to investor protection and investor confidence in financial markets.

Nevertheless, MiFID II does not regulate or intend to harmonize such redress systems. Article 69 of the Directive refers to a right of redress for aggrieved investors as it requires that "*Member States shall* *ensure that mechanisms are in place to ensure that compensation may be 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".* However, there is no guidance as to how the rights to compensation or other remedial action should be exercised. The determination of the potential contractual consequences of a breach of MiFID rules as well as the appropriate institutions and remedies for such breaches remains under the discretion of EU Member States.

In the absence of EU law providing for sanctions for violations of the conduct of business rules, investors are dependent on their national systems. However, these systems strongly differ from one state to another, resulting in inequality with regard to access to justice and ease of obtaining relief. The way in which MiFID rules, such as the conduct of business rules, affect the civil-law relationship between investment firms and their clients, strongly varies across national systems. In some Member States, violations of the conduct of business rules may directly provide a ground for compensation, in others still many other criteria will have to be fulfilled before a civil action can be successful. Even if national law provides for civil liability for infringement of the conduct of business rules, there may be other factors complicating private enforcement. Private redress actions can involve many procedural difficulties. Investors may have difficulties to prove the violation, their damage and the causal link between the two. Also, as the risks involved in many financial and investment agreements often do only materialize over a long period of time, it can take years before the investor can bring a claim and request compensation. Moreover, investors may be reluctant to start private litigation, since this is a costly, complex and financially risky process. Generally there are relatively small amounts at stake, while the costs are considerably high (especially given the often complex nature of investment disputes), depriving potential compensation of restorative effect. All of these difficulties are exacerbated in the cross-border context.

The issue, therefore, is to select a mechanism that delivers redress swiftly, effectively, efficiently, without false results or abuse, with no or minimal costs or barriers for investors to access the procedure, without significant reduction in the redress paid to investors through intermediaries' or transactional costs, and with proportionately low overall transactional cost.

The EU has attempted to do this, by facilitating and harmonizing the institution of alternative dispute resolution and collective redress. ADR mechanisms as well as collective redress mechanisms may provide cheaper, easier and faster ways of dispute resolution and so facilitate access to justice. However, at the moment, these mechanisms are not available in all Member States, or their access or quality may be limited. With the ADR Directive, the ODR Regulation and the Commission's recent Proposal for a "New Deal for consumers", the European Union has taken some steps in the right direction. However, these initiatives as they are now will not be sufficient to overcome the existing issues and to achieve their objective of providing cheap, swift, effective and efficient means to obtain redress.

For this reason, there is a demand for other, more accessible and efficient redress mechanisms. In line with the above objective (to select a mechanism that delivers redress swiftly, effectively, efficiently, without false results or abuse, with no or minimal costs or barriers for investors to access the procedure, without significant reduction in the redress paid to investors through intermediaries' or transactional costs, and with proportionately low overall transactional cost), public redress systems may be preferred. Public redress mechanisms, in particular regulatory redress, could significantly contribute to the ease and speed of obtaining redress whenever infringements occur. Its strength lies in the combined weight of regulatory tools (such as administrative fines, alteration of license permits, etc.) and compensatory tools. Providing redress to aggrieved investors can be incentivized by leniency in other enforcement tools and sanctions or by the advantage of maintaining high commercial reputation.

Regulatory redress may take many forms, and competences of regulatory authorities may vary from formal powers to order redress towards more informal persuasion powers. As long as three essential aspects relating to their structure and design are present, regulatory redress can be achieved successfully: (i) delivery of mass redress powers is to be considered a function of enforcement (and thus a part of the enforcement policy), (ii) public enforcers must adopt an approach to enforcement that envisages the deployment of mass redress powers, and (iii) public enforcers should have an 'integrated toolbox' approach to enforcement (i.e. the authority should be able to settle all facets of a case in one comprehensive agreement and order redress as a condition for this settlement. The authority should be able to 'threaten' with of the use of alternative powers, such as administrative fines, public warnings and amendment or removal of license, in case that the redress commitments are not complied with).

Currently regulatory redress mechanisms are rare. The United Kingdom is unique in establishing a formal regulatory redress mechanism for investment disputes. Under its national law, the financial watchdog, the FCA, is attributed the power to require investment firms that are in breach of the requirements applicable to them to establish and operate a consumer redress scheme or a single firm scheme. Under these schemes, the FCA can require firms to determine what redress should be paid in respect of the firm's failure and to make the redress to affected parties. Where investment firms fail to make such a determination under a consumer redress scheme or where investors are dissatisfied with the determination made, they can make a complaint to the FOS, who can take a legally enforceable decision on whether the firm should take or should have taken particular action in relation to the investor, such as a money award, and can direct the firm to take that action. Alternatively, the FCA can effect a single firm scheme by (threatening to) altering a firms' permission or authorization to operate.

Another example of regulatory redress is the settlement between the Belgian FSMA and the BNP Paribas Fortis. Under the conditions of this settlement BNP Paribas Fortis had to compensate investors that were harmed by the banks inadequate provision of services relating to Greek government bonds. The settlement is remarkable as the FSMA did not have the explicit power to order firms to make redress to aggrieved investors, but has creatively used its powers to approve a settlement with firms that have violated the requirements applicable to them.

Both examples of the FCA and the FSMA show that regulatory redress can be an effective mechanism in obtaining investor redress, and therefore in serving investors interests and restoring the market balance when infringements occur. Unfortunately, these examples are rare, and the majority of the Member States does not have a system for (or a precedent of) regulatory redress. To improve current deficiencies in (enforcement of) investor protection and to provide aggrieved investors with truly effective means to obtain compensation, harmonization of regulatory redress powers is desirable. Nevertheless the EU has hitherto been inhibited form harmonizing such public enforcement powers, because of a lack of jurisdiction under the Treaties and the application of the principle of subsidiarity. Harmonization of public enforcement powers remains a sensitive issue. Direct regulation of regulatory redress powers (which could for instance be achieved through an extension of the powers in Article 69 of MiFID II) may therefore not be conceived well in all European member States. Particularly in light of the current, increasingly Eurosceptic political framework such direct regulation of public redress powers could be considered intrusive of national sovereignty. Other, less 'intrusive' ways of harmonization may therefore be more feasible. In this regard one could consider advancement of regulatory redress mechanisms through ESMA's Opinions or Guidelines (or other tools aiming at 'voluntary' supervisory convergence) or by promotion of the UK system and the FSMA-BNP Paribas Fortis precedent as best practices, stimulating other financial supervisors to pay more attention to the interests of aggrieved investors and to use the powers given to them under national law more creatively. Even though these options do not directly create a legal basis for financial supervisors to order redress, they can contribute to the acceptance of such powers and, ultimately, help to create a stronger framework for investor protection and to ensure equitable, effective access to redress for aggrieved investors.

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