REPORT

EC Financial Services and Contract Law – Developments 2005–2007

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Abstract: The contribution is a follow-up of the overview published in ERCL 2005, 482. While the law with respect to prudential supervision changed little, contract law developed considerably. This is so despite the fact that no important new legislation has been adopted: In the area of commercial banking, the new Consumer Credit Directive is still under discussion. There is, however, an ambitious project to regulate all payment instruments in one sole legal measure, namely: credit transfers, credit and debit cards and direct debit. In the area of investment banking, the Market in Financial Instruments Directive of 2004 (MiFID) had to be transposed in the Member States until 1st November 2007. This is important because the so-called Lamfalussy regulatory architecture which was used for this directive is about integrating more coherently EC legislation, national transposition and effective implementation. Therefore, while giving a general overview as well, the article concentrates on these two developments: the proposal for a payments directive and the transposition of the MiFID.

I. Prudential and Market Supervision

Prudential and market supervision – as the second large area of financial services law besides contract law –[1] has undergone relatively little change after the active years around the turn of the century. It remains unchanged that for prudential supervision, commercial banking (namely payment services and loans) and investment banking (namely all services related to investment and capital markets) are seen as parallel, yet independent areas, with their own regulatory regimes. A third regime on prudential supervision applies to insurance undertakings (and one more, less important, to investment firms). While prudential supervision is related to the institutions, mainly their own funds status, market supervision refers to supervision of and legal rules for capital markets.

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1 See already S. Grundmann, 'EC Financial Services and Contract Law – Developments 2002–2005', (2005) 1 *European Review of Contract Law* 482–494, at 482 et seq.

1. The Developments in Prudential Supervision

The developments in the three areas of prudential supervision – namely with respect to the core factor of capital adequacy – can be summarised as follows:[2] In the area of *Commercial Banking*, mainly credits and transfer of credits (payments), the recast of Credit Institutions Directive 2000/12/EC[3] relating to the taking up and pursuit of the business of credit institutions has brought quite technical changes to the system of prudential supervision. But in comparison to Directive 2000/12/EC, however, it also covers the regime of own funds and solvency ratios for commercial banks.[4] In addition, the new Capital Adequacy Directive modified remarkably regulations in the field of capital adequacy concerning commercial banks (with regard to their investment activity) as well as investment firms:[5] In order to modernise supervisory-standards, the Directives establish new own funds requirements: they set lower own funds requirements for the financing of small and medium-sized undertakings. Specific types of risk capital are preferentially treated. Thus the Directives seek to ensure consistent application of the Basel-II-framework, the new international framework for capital adequacy adopted by the Basel Committee on bank monitoring.[6]

2 Certainly, the trend is, to reduce the gap between them and install common rules as in Directive 2002/87/EC, *OJEC* 2003 L 35/1 (on financial conglomerates). Also within the Member States, starting with the United Kingdom (Financial Services Authority, FSA), supervision is increasingly entrusted to one authority only for all three categories, for instance also in Germany (*Bundesaufsichtsamt für das Finanzwesen, BAFin*).

3 Directive 2000/12/EC of the European Parliament and the Council of 20 March 2000 relating to the taking up and pursuit of the business of credit institutions, *OJEC* 2000 L 126/1 (amended by *OJEC* 2000 L 275/38; *OJEC* 2004 L 125/44; *OJEC* 2004 L 145/1; *OJEC* 2005 L 79/9).

4 Directive 2006/48/EC of the European Parliament and the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, *OJEC* 2006 L 177/1 (amended by *OJEC* 2007 L 87/9); see more detailed J.H. Dalhuisen, 'Financial Services, Products, Risks and Regulation in Europe after the EU 1998 Action Plan and Basle II', 5 *European Business Law Review* 2007, 819–1091, 1081.

5 Directive 2006/49/EC of the European Parliament and the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions, *OJEC* 2006 L 177/201; recast of the Council Directive 93/6/EEC of 15 March 1993, *OJEC* 1993 L 141/1 (amendment in *OJEC* 1998 L 204/13, 204/29 and MiFID *OJEC* 2004 L 145/1).

6 See recital No 37 of Directive 2006/48/EC and the explanatory memorandum of COM(2004) 486 final; Basel Committee on Banking Supervision of the Bank for International Settlements, http://www.bis.org/bcbs/ index.htm.

In the area of *Insurance Law*, the Commission has submit a draft for the Solvency-II-Directive:[7] The minimum common standards for adequate financial resources of insurance undertakings set out in the former Directives are under review. Deepening integration of the EU reinsurance market, enhancing protection of policyholders and beneficiaries and improving the international competitiveness of EU insurers are important aims of that initiative.

A new Directive has been put into force to 'implement' the existing Council Directive on *investment funds*:[8] Implementation refers to clarification of definitions of eligible assets for undertakings for collective investment in transferable securities with regard to certain classes of assets. Thus the Commission wanted to ensure a uniform application of Directive 85/611/EC: Because of the development of many new types of financial instruments traded on financial markets, there had been much uncertainty in the past whether those instruments were covered by the definitions of Directive 85/611/EC or not. In the area of investment funds, the Commission is intensively considering an improvement of the Single Market framework: On the basis of consultations and debates with the different market participants, it has developed a White Paper, which shows the Commission's vision of targeted changes to the current EU framework for investment funds:[9] With the forthcoming modification of the Investment Funds Directive the Commission wants to simplify the existing passporting mechnisms and expand the freedoms available to investment funds and their managers. The simplified prospectus and its effective application shall be improved and the Commission aims at enhancing supervisory cooperation.

Questions of *electronic money* remained unchanged up to now: Although the Commission is thinking of a review of the E-Money-Directive,[10] there won't be a proposal before the adoption of the Payment Services Directive.[11]

7 COM(2007) 361 final, Proposal for a Directive of the European Parliament and the Council on the taking-up and pursuit of the business of Insurance an Reinsurance – Solvency II of 10 July 2007.

8 Commission Directive 2007/16/EC of 19 March 2007 implementing Council Directive 85/611/EEC on the co-ordination of laws, regulations and administrative provisions relating to undertakings for collective investments in transferable securities (UCITS) as regards the clarification of certain definitions, *OJEC* 2007 79/11.

9 See in detail COM(2006) 686 final, White Paper on enhancing the Single Market framework for investment funds of 15 November 2006.

10 Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit and prudential supervision of the business of electronic money institutions, *OJEC* 2000 L 275/39.

11 SEC(2006) 1049, Commission Staff Working Document on the Review of the E-Money Directive (2000/46/EC) of 19 July 2006.

2. Capital Market Law and Supervision

After the Adoption of the four large capital market law directives in the first half of the decade – the General Prospectus Directive and the Stock Exchange Directive for primary markets, the MiFID (N 59) and the Market Abuse Directive for secondary markets –,[12] only one major piece of legislation followed: the so-called *Transparency Directive*.[13] This directive only changed duties already existing (and regulated in other directives until then), namely: the principle of equal treatment; the duty to issue interim reports between the annual accounts (periodic information); and the duty to disclose changes in major shareholdings.

II. Contract Law Issues in Commercial Banking

1. Common Standpoint on Consumer Credits

The last report concentrated to some extent on the changes envisaged in the area of consumer credits up to the first amended proposal published by the EC Commission,[14] namely on the question in how far we might witness the transition from a mainly information based system of consumer protection (with annual percentage rate and calculation of all costs) to a more paternalistic system: In the latter, (professional) lenders would owe their clients a duty of 'responsible lending'. The scenario described then, has evolved. The EC Commission has published a second amended proposal which recently has lead to a common standpoint – already accepted also by the EC Commission.[15]

12 For the system of these four directives and material on them, see Grundmann, n 1 above, 484 et seq. For a short description of this system see S. Grundmann, *European Company Law – Organization, Finance and Capital Markets* (Antwerp/Oxford: Intersentia, 2007) 373–473.

13 Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC, *OJEC* 2004 L 390/38.

14 For the most important changes proposed and literature on these changes, see Grundmann, n 1 above, 486–488.

15 (Second) Amended Proposal of 7 October 2005 for a Directive of the European Parliament and of the Council on consumer credits and amending Directive 93/13/EEC of the Council, COM(2005) 483 final; Common Standpoint (EC) n 14/2007 established by the Council on 20 September 2007 with a view to enacting Directive 2007/…/EC of the European Parliament and of the Council of … on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJEC 2007 C 270E/1 and COM(2007) 546 final.

A directive can be expected soon, and its content should not change considerably any longer.[16]

a) Maximum Harmonisation and Internal Market

The maximum harmonisation approach (Article 22 para 1) by which the EC Commission wants to foster the functioning of the Internal Market has been refined. More exceptions have been added – in certain instances the EC Commission now speaks of 'targeted harmonisation' instead. Still in the common standpoint, for instance, the Council has added the exception that Member States may impose additional formalities for the formation of contract protecting the consumer (Article 10).[17] Altogether, however, the EC Commission's approach still prevails. The EC Commission justifies it by the argument that only this guarantees the equilibrium between the concerns of consumer protection and the efficient functioning of the Internal Market. The important task for the future will be to discuss where questions have in fact been harmonised (and Member States may no longer impose more stringent rules) and where a question has been left unregulated – for instance that of maximum interest rates.

b) The Scope of Application and Definitions

After the common standpoint, it is clear that there will not be considerable expansion of the scope of application. Namely the idea of including other contracts similar to loan contracts – such as surety contracts – was finally not successful. Credit is a broad concept insofar as it includes also the giving of credit between the parties, not only the giving of loans. It remains, however, quite narrow with respect to third persons which give credit as well – such as sureties.

The scope of application has not been extended with respect to important types of loan contracts either, namely mortgage backed loans. In this respect the exception has even been extended to similar kinds of asset backed loans (see Article 2 para 2). Finally, also the exceptions with respect to the amount due (minimal or rather large, now above 100.000,– euro) remained unchanged in principle.

16 For the most recent literature, see M. Hoffmann, *Die Reform der Verbraucherkreditrichtlinie (87/102/EWG)*, (Berlin: de Gruyter, 2007); F. Ferretti, 'The Regulation of Consumer Credit Information Systems: is the EU Missing a Chance?', 34(2) *Legal Issues of Economic Integration* 2007, 115–131.

17 There are other explicit exemptions in the Directive but some are as well implicit only. For some implicit exemptions see text to come.

Definitions did not change too much either, namely not that of 'total cost of the credit to the consumer' and of 'annual percentage rate of charge'. There was considerable debate on whether insurance or (other) costs provoked by third parties, namely notaries, should be included. In the end, the solution was to leave out all costs created by third parties except for insurance if the credit has been made depend on the taking of insurance.

c) Information and the Process of Lending

The most interesting part is still that on information.

An interesting question is how standardised it may be and how individual it should be. An important watershed can be found in Article 3 para 1. This paragraph and recitals 25 and 26 still show how intense the discussion was: The consumer should get information in order to compare offers – and best not only offers of the same structure, but as well alternatives, for instance normal loan and a credit combined with a building loan contract. The system of the directive would seem to be to allow Member States to ask for information on the alternatives as well (recital 26) – although Article 3 para 1 clearly specifies that the standard information asked for in lit a) through s) is sufficient and despite the principle of maximum harmonisation.

Another question is that of 'responsible lending'. Again, the common standpoint is a compromise in which the EC Commission's point of view is rather visible in the recitals (recital 25) and left to the discretion of Member States – again, the EC Commission would seem to sacrifice the principle of maximum harmonisation here to a substantive law position for which the EC Commission could not impose its solution. The compromise is that the lender has to make the effort to find out whether the consumer can afford the credit and inform him about the result. There is, however, no sanction in case of violation, and there is certainly no duty to abstain from the giving of risky loans. It seems very clear from recital 26 that the consumer should have at least some responsibility, even if the lender should not have informed him of the risk – and if the lender has informed him properly, the client would clearly have no excuse for taking the risk. Therefore, the sanction (under national law) for the violation of this duty would seem to be at most a sharing of the damages. In fact, it is convincing that even consumers should have some awareness of which level of credit they can afford, and they should not be without incentives to respect this limit. The rule, however, even if it lacks sanctions should have considerable effect: Not many banks will inform their client of a high risk that he can not afford the loan and nevertheless give it to him.

In this context, a new rule on databases is of some importance (Article 9). While the EC Commission wanted to impose on Member States a duty to

introduce a data base on individual debtor's compliance, the rule upheld in the Common Standpoint is only that lenders of all Member States should at least have the access to databases already existing in other Member States. This might indeed well have been one of the important barriers to cross-border lending so far.

d) Early Termination

Among the many other changes – many of some importance, but all remaining within the framework of what existed already under the old directive –, one should still be mentioned. Again the rule has found its final form only in the Common Standpoint: Early termination is restricted only in cases where not only the term was fixed but as well the interest rate (this was so already under the old directive). Once the interest rate is not or no longer fixed, the loan can be terminated anyhow. In the other cases, the directive has now found a solution to the hold-up problem inherent to loans where the debtor no longer can use the loan or where he would like to extend the sum, but his bank does not want to give this additional loan. In this case, early termination (potentially combined with the finding of a new partner), is often the only solution. Over the last decades, some national courts, among them the German Supreme Court, had developed detailed case law not allowing the lenders to charge all interests due until expiration of the term.[18] The Directive, while defining interests and costs owed for the remainder of time as the core criteria in para 1, fixes as well two limits which in practical result may well constitute the most meaningful part of the rule: Compensation is owed only in cases where the Central Bank competent has lowered the interests since formation of the loan contract, moreover it is limited to only 1 % of the amount of the loan restituted early (0,5 % if the loan would have ended within one year anyhow). The idea is that in case of rising interests, there is a windfall profit for the lender anyhow because he can now lend at a higher price and this should compensate the costs. The rule is simple indeed, perhaps too simple: Banks and interest rates can fall considerably, for more than 1 %; at least in some Member States, costs are distributed evenly, thus leaving a substantial part unpaid in case of (very) early termination; and even when the interest rates remained unchanged, there is no compensation (for instance for the costs of new lending efforts needed). Anyhow, the question is that of finding clients, not money to lend: A new client would have got the credit irrespec-

18 The lead cases are *Bundesgerichtshof Reports (BGHZ)* 136, 161 = *Neue Juristische Wochenschrift (NJW)* 1997, 2875; Bundesgerichtshof *Neue Juristische Wochenschrift (NJW)* 1997, 2878; now § 490 para 2 of the German Civil Code (BGB); for the most recent developments, see standard commentaries on this rule.

tive of whether another client restitutes early. Banks will (have to) consider clients' extended possibility to terminate early without meaningful compensation and reflect this in their (general level of) prices. Thus, those clients who terminate early will live at the expense of those who do not. This, however, does not apply to the consumer credit market which is the most important and where such an extended license to terminate early would be particularly harmful: Mortgage backed loans and other asset backed loans are excluded (see above).

2. A New Era for Credit Transfers?

a) Payment Services Directive (PSD) as Legal Framework for Payment Services

On 15 October 2007 the Council adopted in First Reading a directive which is aimed at establishing a legal framework for payment services in Europe for the first time.[19] The PSD enters into establishing an efficient and modern payment system regulating all payment instruments – credit transfers as well as direct debits and cash deposits. Starting point of the Commission's initiative to create the PSD[20] was its estimation that progress on harmonisation had not gone far enough in the past: although the Credit Transfer Directive[21] and the regulation on cross-border payments[22] had facilitated many types of payments in euro within the Internal Market, important areas of payment services still remained unharmonised. To support the payment-industry's initiative for a Single Euro Payment Area (SEPA) the Commission has worked out an ambitious proposal: it is to help to enhance competition and create a level playing field between national markets and for this purpose it aims at increasing market transparency for both providers and users.

Even if the Commission's original proposal has undergone rather significant changes in the legislative procedure – especially concerning the scope of application –, the directive now adopted by the Council still contains the core elements of the new framework for payment services: these are definitions and regulation of Payment Institutions including supervisory regulations (title II), transparency of conditions and information requirements for payment services (title III) and regulations on rights and obligations in relation

19 PE-CONS 3613/07.

20 COM(2005) 603 final.

21 Directive 97/5/EC of the European Parliament and of the Council of 27 January 1997 on cross-border credit transfers, *OJEC* 1997 L 43/25.

22 Regulation 2560/2001 of the European Parliament and of the Council of 19 December 2001 on cross-border payments in euro, *OJEC* 2001 L 344/13.

to the provision and use of payment services (title IV). The latter two parts contain a rather exhaustive body of contract law on all important payment systems (other than payment in cash).

b) Scope of Application

While the Commission's proposal in principle opted for a wide scope of application which covered not only payments in euro but also in any other currency and already applied if only one of the service providers was located in the Community, and only excluded payments not exceeding an amount of 50.000 euro, the Parliament saw the need for modifications: for the sake of consumer protection, the limitation to a specific amount has been rejected. On the other hand, the original proposal has been estimated to be too ambitious, therefore the directive should now apply only where all service providers involved are located in the Community.[23] According to Article 2 of the Directive now adopted by the Council it only applies to 'payment services provided within the Community', for the most important titles III and IV, those on contract law, it is made very clear that they only apply where the service providers are all located in a Member State. The scope is limited to payments in euro and Member State currencies outside the euro area. Neither cash payments directly from the payer to the payee, nor payment transactions in the money exchange business where funds are not held on a payment account, nor paper cheque or paper-based traveller's cheque payments are included.[24]

c) Payment Institutions – new Payment Service Providers for more Innovation and better Competition

Up till now, Community Law only governs the supply of payment services by credit institutions,[25] electronic money institutions[26] and (via exemption)

23 For explanation, see A6-0298/2006 Report on the proposal for a directive of the European Parliament and the Council on payment services in the internal market and amending Directive 97/7/EC, 2000/12/EC and 2002/65/EC of 20 September 2006, Committee on Economic and Monetary Affairs, Opinion of the Committee on the Internal Market and Consumer Protection, 113 seq.

24 See the rather extended catalogue of exceptions contained in Art 3 and Recital No 19 of the Directive, PE-CONS 3613/07.

25 Directive 2006/48/EC of the European Parliament and the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions, *OJEC* 2006 L 177/1 (amended by *OJEC* 2007 L 87/9).

26 Directive 2000/46/EC of the European Parliament and of the Council of 18 September 2000 on the taking up, pursuit of and prudential supervision of the business of electronic money institutions, *OJEC* 2000 L 275/39.

post office giro institutions.[27] By introducing the new category of payment service providers named Payment Institutions, Commission, Parliament and Council want to lower market entry barriers and enforce competition in the area of payment services:[28] Thus, new potential competitors – such as supermarkets, telecom- and IT-providers – are to be enabled to offer payment services. Two instruments are paramount for this aim: The Directive on the one hand provides arrangements to grant equal access to the services of technical infrastructures of payment systems for Payment Institutions[29] – just as credit institutions have. On the other hand, the Directive builds a framework of supervision for these new entrants on the market of payment services.

Title II chapter 1 of the Directive deals in detail with questions of authorisation,[30] initial capital and own funds and their calculation[31] and it lays down rules for registration.[32] The Member States are urged to designate competent authorities for those matters of supervision. Being authorised in one Member State, Payment Institutions can provide payment services – such as placing cash on and enabling cash withdrawals from a payment account, execution of direct debits, credit transfers and execution of payment transactions through a payment card – in the entire Community.[33]

d) Contract Law Contents I – Information Requirements for Payment Service Providers

The new framework for payment services does not only aim at more competition and innovation. Consumer protection is to be enforced by the new Directive as well. Here central remedies are transparency and information before, during and after the execution of payment services. Besides, the Directive tries to lay down rights and obligations for providers and users of payment services (see below section e)).

27 More detailed U. Burgard, 'Der Vorschlag der Kommission für eine Richtlinie über Zahlungsdienste im Binnenmarkt', in *Wertpapiermitteilungen, Zeitschrift für Wirtschafts- und Bankrecht* 2006, 2065–2071, 2066.

28 See Recitals No 10 and 16 of the Directive, PE-CONS 3613/07, and Recital No 8 of the Commission's proposal, COM(2005) 603 final.

29 Art 28 and Recital No 16 of the Directive, PE-CONS 3613/07.

30 Art 5, 10–12, 14 and Recitals No 10, 11, 14 of the Directive, PE-CONS 3613/07.

31 Art 6–8 and Recital No 11 of the Directive, PE-CONS 3613/07; Art 7 para 1 refers to certain aricles of the Directive 2006/48/EC (see N 4), which provides regulations concerning the own funds of credit institutions.

32 Art 13 and Recital No 15 of the Directive, PE-CONS 3613/07.

33 Art 10 para 9 and Recital No 10 of the Directive, PE-CONS 3613/07.

Different from what the EC Commission had originally proposed, the information requirements of title III (applying to single payment transactions and framework contracts together with payment transactions covered by them) shall not apply in a mandatory way if the payment services user is not a consumer.[34] As enterprises and organisations are less in need of protection than consumers, parties, by mutual consent, can wave the information requirements – wholly or in part.

For the sake of information duties, but as well for other questions, the proposal for the directive distinguishes between single payment transactions and (payment transactions within) framework contracts. For *single payment transactions*, the Directive creates a system of information requirements starting with precontractual obligations. According to Articles 36 and 37, the payment service provider has to make available to the user information referring to the maximum execution time, all the charges which the user has to pay and he has to specify the information which the user has to notify for a proper execution of the order. Immediately after having received the payment order, the service provider has to inform the user (or make the information available to him) about all important facts of the transaction: First of all, the user must get some kind of identity-reference to be able to identify the transaction. Furthermore, the amount and currency of the payment transaction as well as the amount of all the charges payable and the date of receipt of the payment order are objects of the information that has to be transmitted.[35] Similarly, there is a third step of information requirements after the completion of the transaction: Now the payee has to be informed by his payment service provider about the identity-reference, the amount of the payment transaction and all the charges – here accompanied by information about the credit value date.[36]

For *framework contracts,* the information requirements are even more detailed and more stringent. Before being bound by the contract or the offer, the user has to be given certain core information on paper or on another durable medium, for instance the name and address of the payment service provider including electronic mail address, a description of the main characteristics of the payment service provided, the modalities for giving consent to execute a payment transaction, and information about the possibility to determine

34 Art 30 para 1 and Recital No 20 of the Directive, PE-CONS 3613/07.

35 Art 38 of the Directive, PE-CONS 3613/07; the proposal of the Commission provided even more and more detailed information requirements, e.g. indication of the law applicable and the competent court, indication of redress and complaint procedures; see Art 25 et seq of COM(2005) 603 final.

36 Art 39 of the Directive, PE-CONS 3613/07.

spending limits for the use of the payment instrument – to name just a few. Moreover, the service provider has to tell the user about the means of communication within their contractual relationship, about measures to keep safe a payment instrument and how to notify the loss, theft or other missappropriation of the payment instrument to the service provider, about duration of the contract and the user's termination right.[37] Provisions for the latter are made in Article 45 of the Directive: The period of notice for the user may not exceed a month. The service provider may terminate a framework contract concluded for an indefinite period by giving at least two months' notice.[38]

Moreover the Directive lays down information requirements in the context of the execution of individual payment transactions within a framework contract relationship comparable with those for single payment transactions.[39] In addition, the payee's payment service provider has to give to him the same kind of information.[40]

e) Contract Law II – Contract Formation, Contents and Liability Rules

With respect to Contract Law, title IV is of special interest: the contractual relationship between provider and user is regulated by the Directive quite extensively. This is true in particular for questions of liability which, after the implementation in the Member States,[41] will be governed by Community Law in a mandatory way. Only if the payment service user is not a consumer or in case of low value payment service instruments and electronic money, derogation is possible to a limited extent.[42]

First, *consent and withdrawal of consent* to payment transactions are regulated.[43] The Directive allows the parties to agree on spending limits for payment transactions where a specific payment instrument is used for giving consent and it gives the right to the service provider to block the instrument – of course accompanied by information requirements.[44]

The payment services user is obliged to use the payment instrument he has received *safely* and in accordance with the framework contract – he must take

37 Art 42 of the Directive, PE-CONS 3613/07, divided into seven sub-paragraphs, each of them subdivided again (up to six times).
38 Art 45 and Recital No 29 of the Directive, PE-CONS 3613/07.
39 Art 46 and 47 of the Directive, PE-CONS 3613/07.
40 Art 48 of the Directive, PE-CONS 3613/07.
41 According to Art 94 para 1 of the Directive, PE-CONS 3613/07, the Member States have to implement the Directive before 1 November 2009.
42 Art 51 and 53 of the Directive, PE-CONS 3613/07.
43 Art 54 of the Directive, PE-CONS 3613/07.
44 Art 55 of the Directive, PE-CONS 3613/07.

care of his Personal Identification Number, for example. He has to notify loss, theft, missappropriation or any unauthorised use.[45] The Directive provides organisational obligations for the service provider to ensure the safety of payment instruments and see for the personalised security features belonging to them.[46]

Articles 60 and 61 establish a new system of liability: The payment service provider has to refund the amount of any unauthorised transaction to the payer. However, the payment service user must have notified the unauthorised transaction without undue delay on becoming aware of it (Article 58 of the Directive). Did the user act according to these regulations and does he deny having authorised that transaction, it is up to the service provider to prove that the transaction was authorised, accurately recorded, entered into accounts and not affected by a technical defect.[47] Did an unauthorised transaction happen, because the payment instrument had been stolen or lost or for the user has not observed the personalised security features, the service provider may reduce the refund by up to 150 euro. If the customer acts deceitfully or violates his obligations under Article 56 on purpose or in a grossly negligent way, he shall be liable for all the losses.[48] With regard to direct debits, the Directive finally contains regulations on refunds for payee-initiated transactions.

If a service provider refuses to execute a payment order,[49] he has, according to Article 65 of the Directive, to notify this (or make this information available) to the user as soon as possible. Payment orders in principle are irrevocable – except from direct debits, which the payer may revoke for a short period of time.[50]

The general execution time which the Directive establishes ends the following business day for payment transactions in euro and other Member State

45 Art 56 of the Directive, PE-CONS 3613/07.

46 Art 57 of the Directive, PE-CONS 3613/07.

47 Art 59 of the Directive, PE-CONS 3613/07.

48 In cases of gross negligence, according to Art 61 para 3 of the Directive, PE-CONS 3613/07, the Member States may reduce the liability of the user.

49 Which is not possible, if all the conditions laid down in the payer's framework contract are fulfilled, according to Art 65 para 2 of the Directive, PE-CONS 3613/07.

50 According to Art 66 para 3 of the Directive the payer may revoke the payment order by direct debit at the latest by the end of the business day preceeding the day agreed for debiting the funds. This would imply a major change in jurisdictions which, such as Germany, have allowed revocation until the amount has been credited to the payee or his bank (see § 676a para 4 German Civil Code (BGB)).

currencies.[51] The Directive also provides for regulations concerning the value date: The transaction amount has to be credited to the payee's account the same business day on which it is credited to the payee's payment service provider's account.[52] In case of non-execution or defective execution, the payer's service provider is in principle liable for correct execution, unless he is able to prove that the transaction amount has reached the payee's payment service provider. The Directive provides for a very detailed regulation here which includes a rule on recourse against the other members in the credit transfer chain down to the ultimate responsible.[53]

Finally, the Directive wants the Member States to provide for complaint procedures and out-of-court redress procedures.[54] Thus, cheap, fast and easily accessible measures for the resolution of conflicts between payment service users and providers are to be granted.

f) PSD – another Step towards an Integrated Market of Payment Services

The (proposed) Payment Services Directive – now adopted by the Council – is about to build a legal framework for payment services in Europe. It's regulations are detailed and complex and cover many aspects of payment services. The attempt to regulate the entire area of payment services should be seen positively. This does not exclude to ask the question whether eg each information requirement for payment service providers is sensible and practicable, or whether payment services in part may be more complicated and expensive in the future. The same question can be asked for the liability regulations set up by the Directive. In the end, only practice will give the answer.

III. Contract Law Issues in Investment Banking – the Implementation and Transposition of the MiFID

1. Importance of the MiFID

While Europe is struggling for a Reform Treaty and/or Constitution, for investment banking, it can be said without exaggeration that with the Markets in Financial Instruments Directive (MiFID), it got its new constitution in the

51 Art 69 of the Directive, PE-CONS 3613/07; until 1 January 2012, payment service providers and users may agree on a period up to three business days; for paper-based transactions the parties may agree on an extension by one more business day.

52 Art 73 of the Directive, PE-CONS 3613/07.

53 Art 74 to 78 of the Directive, PE-CONS 3613/07.

54 Art 80 to 83 and Recitals No 50 to 52 of the Directive, PE-CONS 3613/07.

area of investment services and secondary capital markets.[55] In fact, one of the core reasons for reform was that the European legislature had the intention to regulate the whole range of offers in the investment industry, not only some core types of offers, and that he wanted to cover also alternative (secondary) market systems,[56] ie that he wanted to regulate the whole secondary capital market.[57] This entailed as well a need of more pronounced differentiation within the regulation: according to types of offers made, but as well according to clients approached.[58] Thus, the regulation is more detailed and more severe with respect to some offers or clients, but leaves more lee-way with respect to others.

Apart from the broad approach taken and the large importance of the investment business, investment services is paradigmatic also in other respects. Investment services is probably the most important example for the phenomenon that contract law in the area of financial services is partly superseded by (market) supervision rules. Moreover, investment services is the most striking example for an application of the Lamfalussy philosophy in the area of contract law. This can best be explained with reference to the legal acts now enacted:

55 At least, authors in Germany, pronounce themselves in this sense quite readily: K.J. Hopt, 'Grundsatz- und Praxisprobleme nach dem Wertpapierhandelsgesetz – insbesondere Insidergeschäfte und Ad-hoc-Publizität', *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht* 159 (1995) 135, 135; similarly H.-D. Assmann / U.H. Schneider, *Wertpapierhandelsgesetz* (Cologne: Otto Schmidt, 2006) Introduction n 1; *Kölner Kommentar zum WpHG* (Cologne, Berlin, Munich: Heymanns, 2007) Introduction n 3 (arranged by H. Hirte / Th. Henrich).

56 On alternative (secondary) market systems, not dealt with in the following, see namely Ch. Kumpan, *Die Regulierung außerbörslicher Wertpapierhandelssysteme im deutschen, europäischen und US-amerikanischen Recht* (Berlin: de Gruyter, 2006); I. Domowitz, 'An Exchange Is a Many-Splendored Thing: The Classification and Regulation of Automated Trading Systems', in A. Lo, *The Industrial Organization and Regulation of the Securities Industry* (Chicago, London: University of Chicago Press, 1996) 93–115; D. Cohn-Heeren, *Kapitalmarktrechtliche Regulierungskonzepte für Altenative Handelssysteme* (Berlin: Duncker & Humblot, 2006); D. Loff, *Alternative Handelssysteme* (Lohmar, Cologne: Josef Eul, 2007).

57 See Recitals No 2 and 5 of the MiFID; H. Fleischer, 'Die Richtlinie über Märkte für Finanzinstrumente und das Finanzmarkt-Richtlinie-Umsetzungsgesetz – Entstehung, Grundkonzeption, Regelungsschwerpunkte', *Zeitschrift für Bank- und Kapitalmarktrecht* 2006, 389, 390 et seq.

58 Grundmann, n 12 above, n 758 et seq, 767.

2. Legal Acts Around the MiFID

The Markets in Financial Instruments Directive (MiFID) of 2004[59] forms the basic legal act and superseded the much less detailed Investment Services Directive of 1993. According to the Lamfalussy philosophy, only core principles are to be set at the first level (EC Commission and EU Parliament).[60] At the next levels, professional circles, mainly from the supervisory authorities, are dominant: This is so on the second level, the specification of more specific rules on the EC level (by CESR). The legal measures on the second level have now been taken: a directive which is important in the area of rules of conduct and rules regarding the organisational duties of investment providers;[61] and a regulation which is mainly about definitions and prudential supervision proper and less important in our context.[62] Professional circles are dominant also on level three and four: implementation and cooperation on the national levels. The MiFID and the implementing acts had to be transposed into national law until 1 November 2007. Important Member States

59 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 [see n 6], *OJEC* 2004 L 145/1; for this measure see G. Ferrarini, 'Contract Standards and the Markets in Financial Instruments Directive (MiFID): An Assessment of the Lamfalussy Regulatory Architecture', (2005) 1 *European Review of Contract Law* 19–43; A. Knight, The Investment Services Directive – Routemap or obstacle course, (2003) 11 *Journal of Financial Regulation and Compliance,* 219–224; C. Chance LLP, 'EU legal and regulatory developments: Safeguarding of client assets: CESR's technical advice in relation to Directive 2004/39/EC on Markets in Financial Instruments (MIFID)', (2004) 11 *Derivates Use, Trading Regulation* 67–74.

60 Critical in this respect in the case of the MiFID: Ferrarini, n 59 above.

61 Directive 2006/73/EC of the EC Commission of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *OJEC* 2006 L 241/26.

62 Regulation (EC) Nr 1287/2006 of the EC Commission of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards recordkeeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive, *OJEC* 2006 L 241/1.

have in fact adapted their law now, among them France,[63] Germany[64] and Great Britain.[65]

The idea was to increase professionalism and to speed up reaction to increasingly rapid changes in financial markets. Moreover, the legislature aimed at a much higher degree of uniformity which was seen as necessary for increasing

63 *Journal Officiel de la République Française, texte 4 sur 142*, of 21 February 2007, *Loi n° 2007-212 du 20 février 2007 portant diverses dispositions intéressant la Banque de France (1)*, Art 9 para 2, and *Journal Officiel de la République Française, texte 8 sur 106*, of 13 April 2007, *Ministère de l'Économie, des Finances et de l'Industrie, Rapport au Président de la République relatif à l'ordonannce n° 2007-544 du 12 avril 2007 relative aux marchés d'instrument financiers*; for other Member States see Austria, *Bundesgesetzblatt für die Republik Österreich 2007 I, ausgegeben am 31. Juli 2007, 60. Bundesgesetz, mit dem ein Bundesgesetz über die Beaufsichtigung von Wertpapierdienstleistungen (Wertpapieraufsichtsgesetz 2007 – WAG 2007) erlassen wird, sowie das Bankwesengesetz, das Börsengesetz 1989, das Investmentfondsgesetz, das Kapitalmarktgesetz, das Finanzmarktaufsichtsbehördengesetz das Konsumentenschutzgesetz und die Gewerbeordnung 1994 geändert werden* and *Bundesgesetzblatt für die Republik Österreich 2007 II, ausgegeben am 27. August 2007, 215. Verordnung der Finanzmarktaufsichtsbehörde (FMA) über die Auslagerung der Verwaltung von Privatkundenportfolios an Dienstleister mit Sitz in einem Drittland (Auslagerungsverordnung – AusV),* and the Netherlands, *Staatsblad van het Koninkrijk der Nederlanden, Jaargang 2007, 406, Wet van 30 oktober 2007 tot wijziging van de Wet op het financieel toezicht ter implementatie van richtlijn markten voor financiële instrumenten (Wet implementatie richtlijn marlten voor financiële instrumenten)*, and *Staatsblad van het Koninkrijk der Nederlanden, Jaargang 2007, 408, Besluit van 30 oktober 2007, houdende vaststelling van het tijdstip van inwerktreding van de Wet implementatie richtlijn marlten voor financiële instrumenten en houdende het tijdstip van inwerktreding van het Besluit gereglementeerde markten Wft*.

64 *Gesetz zur Umsetzung der Richtlinie über Märkte für Finanzinstrumente und der Durchführungsrichtlinie der Kommission* (*Finanzmarktrichtlinie-Umsetzungsgesetz – FRUG*) of 16 July 2007, *Bundesgesetzblatt* 2007 I, 1330; with implementing regulation *Verordnung zur Konkretisierung der Verhaltensregeln und Organisationsanforderungen für Wertpapierdienstleistungsunternehmen* (*Wertpapierdienstleistungs-Verhaltens- und Organisations-Verordnung – WpDVerOV*), *Bundesgesetzblatt* 2007 I, 1432.

65 Statutory Instruments 2006 No 2975, The Financial Services and Markets Act 2000 (Markets in Financial Instruments) (Modification of Powers) Regulations 2006 of 15 November 2006; Statutory Instruments 2006 No 3384, The Financial Services and Markets Act 2000 (Regulated Activities) (Amendment No 3) Order 2006 of 18 December 2006; Statutory Instruments 2006 No 3385, The Financial Services and Markets Act 2000 (EEA Passport Rights) (Amendment) Regulations 2006 of 18 December 2006; Statutory Instruments 2006 No 3386, The Financial Services and Markets Act 2000 (Recognition Requirements for Investment Exchanges and Clearing Houses) (Amendment) Regulations 2006 of 18 December 2006; No 3413, The Financial Services and Markets Act 2000 (Disclosure of Confidential Information) (Amendment) Regulations 2006 of 19 December 2006; No 3414, The Financial Services and Markets Act 2000 (Appointed Representatives) (Amendment) Regulations 2006 of 19 December 2006.

the efficiency of European capital markets. This increase in uniformity was indeed the basis for yet another radical change: Also with respect to rules of conduct (ie contract law rules), the EC legislature switched from the host country principle (host country responsibility for additional rules) to a home country principle. All this entails one more trend: Power is increasingly shifted from the private law courts to supervisory authorities and their staff.

3. Contract Law Contents in the MiFID

For contract law, the rules of conduct are most important. They are to be found in Article 18 and 19 of the MiFID which – as formerly Article 11 of the ISD – contains *three core rules*: (1) Any provider of investment services has to provide individualised (not only standardised) information about the instrument into which the client should invest and as well about the suitability of this instrument for the particular client ('know your customer' rule). He has to adapt this information to the degree of professionalism of each client individually. (2) Any provider of investment services has to avoid conflicts of interest if ever possible, or at least to mitigate them, for instance by informing the client about it in order to 'warn' him and make him take his own precautions. And (3) the provider of investment services has to act (solely) in the interest of the client whenever it acts for him (strict fiduciary duty of loyalty). These are in fact old contract law rules, but coined also as standards checked by the supervisory authority under the MiFID (and already under the ISD since 1993). Thus, contract law is supplemented by a competence to supervise the compliance with these rules and this has important consequences. When now rules have been elaborated with much more detail – for the purposes of supervision –, this has repercussions also in contract law. Contract law now increasingly only 'follows' the law of prudential supervision.

The MiFID, the implementing acts on the EC level and the transposition on the national levels have not only led to a multi-layered system in which collaboration on a quasi-common body of law has substantially increased. These acts now also give the picture of a very detailed set of rules:

With respect to *disclosure of information*, this starts with the duty to give (standardised) information on the provider of investment services, his philosophy of investment advice and of dealing with conflicts of interests, the places of execution and the costs of transactions (overall and the fees charged by the particular provider). With respect to information, this continues with a duty to give individually shaped information which is varied according to which offer is at stake or which type of client: When investment advice is given or portfolio management is offered, the provider of investment services has to counsel (non-professional) clients on how high their knowledge and

their experience of the risk is, on which investment strategies are appropriate for him and on his financial situation which allows him to bear which type of investment.[66] The provider thus has to ask for a substantial amount of information ('know your customer'), process it and give investment advice or take investment decisions on this basis. Portfolio managers even have to develop adequate and meaningful benchmarks to allow the client to assess their performance. With respect to these two types of investment services, the duty of the provider of investment services is to find and recommend the 'suitable' investment for and to the client (so-called 'suitability' standard). Otherwise the provider of investment services has abstain from advice or portfolio investment, even if the reason for his lack of certainty lies in the client' behaviour who did not give him sufficient information on himself. These standards are less stringent for all other investment services,[67] namely mere execution of an order, and for other types of clients, namely professional clients. Even in all other investment services, however, at least the knowledge and the experience of a non-professional client have to be investigated into. By this, at least the 'appropriateness' of the investment has to be checked. If the result of this investigation is not positive, warnings have to be given (although in this area, the provider of investment services may go on with the service if these warnings remain unheard). Outside the professional circles, only in a relative narrow area, a pure and simple execution only is allowed (no investigation at all, Article 19[6] MiFID).

With respect to *conflicts of interests*, the MiFID confirmed the philosophy that most has to be done via organisational rules, namely via compliance rules and chinese walls (Article 13[3], 18 MiFID). However, it brought about also substantial change: It is now clear that a provider of investment services has to do all to detect such conflicts of interests at all and that he has to disclose conflicts of interests and their exact mechanism where he cannot neutralise a conflict of interests by organisational devices and cannot exclude that this conflict of interests might harm the client in one instance or another (Article 18 MiFID); this duty to disclose should have radical repercussions in the

66 On the standard in the area of investment advice and portfolio management (Art 19[4] MiFID), see more extensively Ferrarini, n 59 above, 35; P. Mülbert, 'The Eclipse of Contract Law in the Investment Firm-Client-Relationship: The Impact of the MiFID on the Law of Contract from a German Perspective', in G. Ferrarini, *Investor Protection in Europe, Corporate Law Making, the MiFID and Beyond* (Oxford: Oxford University Press, 2006) 299–320, 304 et seq.

67 On the standard in this second area (Art 19[5] MiFID), see more extensively Grundmann, n 12 above, n 767 et seq.

business, for instance when an provider of investment services has to disclose the percentage he earns in products offered by a subsidiary.[68]

With respect to the *duty of loyalty* (and partly also the duty of care), important developments are that now best execution of clients' orders is regulated in considerable detail.[69] This does not only follow the general trend to more detail, but was particularly important because of the important increase in alternative trading systems: The core question is which one to choose, one important answer is again disclosure to the client, a duty of loyalty and that the provider of investment services is bound to a strategy guided by clients' interests.

IV. Contract Law Issues in Insurance

Besides the before mentioned proposal for a directive in the area of solvency-supervision (N 7), in insurance there has not been much change in the reporting-period. Namely in the field of contract law, remarkable developments are not on hand.

68 In Germany, these figures typically have not been disclosed so far, and about 50 to 75 % of the offers made were such affiliated transactions; see Stiftung Warentest, *Finanztest* (12/1997), 13 et seq. See more literature on conflicts of interests: Ferrarini, n 59 above, 33; L. Enriques, 'Conflicts of Interest in Investment Services: The Price and Uncertain Impact of MiFID's Regulatory Framework', in Ferrarini, n 66 above, 321–338, 325 et seq.

69 On these questions see Art 21 et seq MiFID; Grundmann, n 12 above, n 761 et seq.