EC Financial Services and Contract Law – Developments 2007–2010

Stefan Grundmann and Christian Hofmann*

Abstract: The contribution is a follow-up on the overview published in ERCL 2008, 45 and covers the latest developments from 2007 through the first half of 2010. The law with respect to prudential supervision has changed little; there are, however, changes underway as a reaction to the financial crisis (see section I). More importantly, however, contract law developed considerably. Important new legislation has been adopted in the area of commercial banking, while the Market in Financial Instruments Directive of 2004 (MiFID) and its transposition were at the centre of the last report. New legislation has now been adopted in the other two important sectors of banking business and thus the series of second generation of banking law directives is complete. In the area of bank loans, harmonisation has changed considerably with the new EU Consumer Credit Directive of 2008. In the area of the payment business, changes have been even more drastic, as virtually all payment instruments have now been harmonised with the new EU Payments Systems Directive of late 2007, and this not only for the consumer area. This directive now covers: credit transfers, credit and debit cards, and direct debits. The importance of the new material makes it necessary to concentrate on these two measures mainly (sections II and III) and to add only two short sections on important developments under the MiFID (section IV) and on some general considerations concerning the overall picture now reached in European Banking Contract Law (section V).

I Prudential and Market Supervision

Prudential and market supervision – as the second large area of financial services law besides contract law – has undergone relatively little change after the active years around the turn of the century.[1] Prudential supervision in commercial banking and in investment banking remain independent areas with their own regulatory approaches – although they are seen as parallel regimes. A third regime on prudential supervision applies to insurance under-

* The first author is Professor of Private Law, European Private and Business Law and Private International Law at Humboldt-Universität, Berlin. The second author is Global Research Fellow at NYU Law School after having been an Alexander von Humboldt Fellow and Visiting Scholar at the University of California, Berkeley, and having received his professorial habilitation at Humboldt University.

1 See already S. Grundmann, 'EC Financial Services and Contract Law – Developments 2002–2005' (2005) 1 *European Review of Contract Law* 482, 482 et seq; S. Grundmann and J. Hollering, 'EC Financial Services and Contract Law – Developments 2005–2007' (2008) 4 *European Review of Contract Law* 45, at 45–48.

takings (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.

The developments in the three areas of prudential supervision can be summarised as follows: in the area of Commercial Banking, mainly credits and transfer of credits (payments), after the 2000/12/EC Directive, there have been few changes but several significant proposals.

1 Deposit Guarantee Schemes and Rescue Funds

The Directive on Deposit Guarantee Schemes has been changed.[2] The minimum coverage level is being increased in two steps: the Directive has increased the minimum coverage from 20,000 € to 50,000 € since 30 June 2009. By 31 December 2010, the coverage for the aggregate deposits of each depositor must be increased to the amount of 100,000 €.

What is more, the financial crisis has shown that the existing rescue scenarios for the failure of a financial institution are insufficient. Practically all countries had to aid their national banks substantially. The discussion on the European as well as the national level focuses on the creation of rescue funds which will continuously be funded by the financial institutions and dispense money to institutions in need and therefore – in theory – relieve the governments from their (newly adopted) rule as lender of last resort.[3] In addition to that, new and special rules for the winding up of banks are necessary, but there is no concept in sight yet.[4]

2 System of Supervisory Authorities

The financial crisis has also shown the extent of globalization in the financial sector. This and the report of the *de Larosière* group[5] has led to the Commission's proposals on the foundation of European supervisory authorities and a European supervisory network, creating the European System of Financial

2 Directive 2009/14/EC of the European Parliament and of the Council of 11 March 2009 amending Directive 94/19/EC on deposit-guarantee schemes as regards the coverage level and the payout delay, *OJEC* 2009 L 68/3.

3 The plans by the European Commission and European leaders to create a European Monetary Fund have been discussed broadly by the media. See eg Businessweek of 9 March 2010: 'European Monetary Fund to Launch by June' (http://www.businessweek.com/globalbiz/content/mar2010/gb2010039_054891.htm).

4 This is a purely academic discussion so far, see D. Zimmer and F. Fuchs, 'Die Bank in Krise und Insolvenz: Aufsätze zur Minderung des systematischen Risikos' *Zeitschrift für Gesellschaftsrecht* 2010, 597, 600.

5 On the Report of the High-Level Group on Financial Supervision in the EU of 25 February 2009 see the Communication from the Commission, COM(2009) 252 final.

Supervisors (ESFS).[6] The institutions to be created (by transforming the existing Committees in the relevant fields) are the European Banking Authority and the European Securities and Markets Authority. They will focus on microeconomic supervision and aim to prevent institutional failure. This approach will be complemented by a macroeconomic supervision by the so-called European Systemic Risk Board (ESRB). It is intended to collect, analyze and evaluate data relevant for systemic stability and to prevent systemic risk.

The purpose of the ESFS is to form a network of the national and the newly created Community supervisory authorities which helps to prevent and to deal with financial crises. The day-to-day supervision of financial institutions will stay at the national level, whereas the ESFS will take up the role of a supervisor, coordinator and mediator among the national authorities. It will also have limited powers to enact emergency measures when a national authority fails to act or a crisis arises. As an example: it may ban short selling on the EU securities markets if considered necessary to prevent further damage in the situation of a financial crisis. Depending on further developments, it may ultimately be granted regular supervisory competences in respect to the market players.

This regime in the field of banking law is complemented by new developments in the insurance law sector which is subdivided into life insurance and others ('damages').[7] The Commission has proposed a regulation on establishing a European Insurance and Occupational Pensions Authority (EIOPA).[8] The day-to-day supervision of insurance institutions is meant to stay at the national level, whereas the EIOPA – similar to the new European authorities in the banking sector – will ensure the consistent application of the rules set by the European legal framework, settle disagreements between national supervisory authorities and safeguard the stability of financial markets in emergency situations based on special powers for specific actions. In combination with the above mentioned proposals on the creation of European supervision authorities in the field of banking supervision, the Commission thus seeks to establish a European System of Financial Supervisors for all relevant sectors of the financial industry.

6 Proposal for a Regulation of the European Parliament and of the Council establishing a European Banking Authority, COM(2009) 501 final; Proposal for a Regulation of the European Parliament and of the Council on Community macro prudential oversight of the financial system and establishing a European Systemic Risk Board, COM(2009) 499 final; Proposal for a Regulation of the European Parliament and of the Council establishing a European Securities and Markets Authority, COM(2009) 503 final. On this see M. Lehmann and C. Manger-Nestler, 'Die Vorschläge zur neuen Architektur der europäischen Finanzaufsicht' *Europäische Zeitschrift für Wirtschaftsrecht* 2010, 87.

7 For the system of directives, see Grundmann (2005), n 1 above, n 7.

8 Proposal for a Regulation of the European Parliament and of the Council establishing a European Insurance and Occupational Pensions Authority, COM(2009) 502 final.

3 Market Supervision and Particular Sub-Sectors

Finally, in the area of Investment Banking, mainly dealing in financial markets instruments, after the 93/6/EEC directive and mainly the MiFID,[9] there have also been initiatives in the area of prudential supervision. The regulators have grown more suspicious of so-far unregulated market players. Alternative investment funds have been suspected of having had their share in the causes and effects of the financial crisis. As a result, regulation is on the way.[10] Hedge Funds, especially, are considered potentially harmful to the stability of the financial markets. The regulatory proposals are nevertheless rather moderate: the proposal of the Commission suggests a mandatory registration requirement for alternative investment funds and their obligation to disclose their strategies.

This goes along with other regulatory activities as a result to the financial crisis and, more recently, the crisis in Greece and the speculations of market makers against the rescue efforts by the Central Bank and European countries. Naked short selling has repeatedly been banned in several countries, most recently single-handedly by Germany.[11] This has sparked the European discussion on the need for a regulation on short selling.[12] However, a regulation on the European level seems less than likely since the systemic risk of (naked) short

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 (MiFID), *OJEC* 2004 L 145/1; for this measure see namely 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; S. Grundmann, Commentary to §§ 31 et seq in Bankrecht VI – Wertpapierhandelsgesetz, in: C. Ebenroth, K. Boujong, D. Joost and L. Strohn (eds), *HGB-Kommentar* (2nd ed, Munich: Beck, 2009) (with ample further references): A. Knight, 'The Investment Services Directive – Routemap or obstacle course' (2003) 11 *Journal of Financial Regulation and Compliance* 219; 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.

10 Proposal for a Directive of the European Parliament and of the Council on Alternative Investment Fund Managers and amending Directives 2004/39/EC and 2009/…/EC, COM(2009) 207 final.

11 See the regulation by the Bundesanstalt für Finanzdienstaufsicht of 18 May 2010: 'Allgemeinverfügung der Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) zum Verbot ungedeckter Leerverkäufe in Schuldtiteln von Mitgliedsstaaten der EU, deren gesetzliche Währung der Euro ist, vom 18. Mai 2010'.

12 See D. Zimmer and T. Beisken, 'Die Regulierung von Leerverkäufen de lege lata und de lege ferenda' *Wertpapier-Mitteilungen* 2010, 485, 489 et seq (also on the situation in the US).

selling is highly controversial and, as a result, the need for regulation seems unclear.

Further far reaching changes which should be reported happened rather more ‘at the margins’ of these corner-stones of prudential supervision. The first E-Money Directive was replaced by a new one.[13] Its main purpose is to establish a regime of supervision of e-money-institutions that is coherent with the prudential supervisory regime applying to payment institutions under Directive 2007/64/EC (which is further discussed at II). The changes in the Investment Fund Directive[14] brought about a simplified European passport mechanism and expanded the freedom for managers of investment funds to choose where to invest. Other major changes were about the prospectus (simplification, but as well more efficient supervision) and about cooperation of supervisory authorities.

4 Particular Governance Rules and Executive Remuneration

Moreover, the financial crisis has triggered an intensive corporate governance discussion for banks in particular.[15] The core governance problem is that, in the case of credit institutions, the governance is not only aimed at aligning the interests of management with those of shareholders, but with those of shareholders *and* of depositors (and the public at large). This implies that in the case of credit institutions, the core aim – which is to shape incentives such that long-term strategic thinking is fostered – cannot be entrusted mainly to shareholders’ decisions. Core proposals are as well to prescribe more quality standards for board members (like in the EU Auditors’ Directive for auditors) and an extension of cooperation and of centralized competences in the supervision itself.

13 Directive 2009/110/EC of the European Parliament and of the Council of 16 September 2009 on the taking up, pursuit and prudential supervision of the business of electronic money institutions amending Directives 2005/60/EC and 2006/48/EC and repealing Directive 2000/46/EC, *OJEC* 2009 L 267/7.

14 Directive 2009/65/EC of the European Parliament and 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), *OJEC* 2009 L 302/3.

15 Green Paper of the European Commission of 2 June 2010 on ‘Corporate Governance in Financial Institutions and Remuneration Policy’, COM(2010) 284; see K. Hopt, ‘Editoria’ *Europäische Zeitschrift für Wirtschaftsrecht* 2010, 561.

II EU Payment Systems Directive

1 Coverage and Core Characteristics

The most important development for European Banking Contract Law over recent years is – late in 2007 – the adoption of the EU Payment Systems Directive.[16] It replaces the EC (Cross-Border) Credit Transfer Directive of 1997,[17] going well beyond it. The new directive covers also purely domestic payments, while the old one had covered only cross-border credit transfers. Moreover, the new directive regulates all payment instruments with the exception of the old completely paper based (and unimportant) instruments such as cheques, bills of exchange and promissory notes. The new directive covers credit transfers, credit and debit cards, and direct debits – all based mainly on electronic processing and much more efficient and economic in handling than all the other methods (including cash payment).[18] In virtually all countries,

16 Directive 2007/64/EC of the European Parliament and of the Council of 13 November 2007 on payment services in the internal market amending Directives 97/7/EC, 2002/65/EC, 2005/60/EC and 2006/48/EC and repealing Directive 97/5/EC [Payment Services Directive], *OJEC* 2007 L 319/1; for this measure see namely U. Burgard, 'Der Vorschlag der Kommission für eine Richtlinie über Zahlungsdienste im Binnenmarkt' *Wertpapier-Mitteilungen* 2006, 2064; J.-U. Franck and P. Massari, 'Die Zahlungsdiensterichtlinie: Günstigere und schnellere Zahlungen durch besseres Vertragsrecht?' *Wertpapier-Mitteilungen* 2009, 1117; S. Grundmann, 'Das neue Recht des Zahlungsverkehrs' *Wertpapier-Mitteilungen* 2009, 1109 and 1157; C. Hofmann, 'Das Haftungsregime für Kartenzahlungssysteme im europäischen Rechtsvergleich – Eine Bestandsaufnahme vor dem Hintergrund des Vorschlags für eine Richtlinie über Zahlungsdienste im Binnenmarkt' *Zeitschrift für vergleichende Rechtswissenschaft* 2007, 174; U. Kulke, 'Die Zahlungsverkehrsrichtlinie und ihre Konsequenzen für den Verbraucher' *Verbraucher und Recht* 2007, 364; M. Lohmann and C. Koch, 'Richtlinie des Europäischen Parlaments und des Rates über Zahlungsdienste im Binnenmarkt – Wesentliche Inhalte, Bewertung und mögliche Auswirkungen auf den europäischen Zahlungsverkehrsmarkt' *Wertpapier-Mitteilungen* 2008, 57.

17 European Parliament and Council Directive 97/5/EC of 27 January 1997 on cross-border credit transfers, *OJEC* 1997 L 43/25; for this measure see namely: M. Brindle and R. Cox (eds), *Law of Bank Payments* (3rd ed, London: Sweet & Maxwell, 2004); X. Favre-Bulle, *Les paiements transfrontières dans un espace financier européen*, (Basel/Frankfurt: Helbing & Lichtenhahn, 1998); S. Grundmann, 'Grundsatz- und Praxisprobleme des neuen deutschen Überweisungsrechts' *Wertpapier-Mitteilungen* 2000, 2269; W. Hadding and U. Schneider (eds), *Grenzüberschreitender Zahlungsverkehr im Europäischen Binnenmarkt – Transboundary Payment Transactions in the European Single Market – Transactions financières transfrontières dans le Marché unique européen* (Cologne: Bundesanzeiger, 1997); M. Malaguti, *Payment Systems in the European Union – Law and Practice* (London et al: Sweet & Maxwell, 1997); A. Stille, *Europäische Prinzipien bei der rechtlichen Behandlung von Banküberweisungen* (Hamburg: Kovac, 2010).

18 This was indeed the core criterion of choice, the directive is aimed at lowering payment costs all over the EU: see Commission Staff Working Paper, annex to the Proposal of the Directive, COM(2005) 603 final, SEC(2005) 1535, C6-0411/05, 5 et seq; J.-U. Franck/

these instruments amount to more than 95 % of the payment volumes and of the payment transaction numbers.[19] All this is regulated for all clients, professional clients and consumers; there is, however, a differentiated approach to protective devices, like in the MiFID before.

The EU Payment Systems Directive is meaningful for a few more general features. The first one is that it follows the full harmonisation approach (Article 86), with very limited exceptions.[20] As it covers the whole area – all relevant instruments, all relevant clients, all relevant transactions – and does so within a full harmonisation approach, the directive reaches a fully fledged regulatory regime – like a mini-codification for payments. This constitutes a truly 'Single European Payments Area' (SEPA) as the system is called. The third feature adds to this impression, and this is an innovative feature in handling the substance: the directive does not treat one payment instrument after the other ('vertically') – as had been the case in many national traditions. Rather it deals with one subject matter after the other for all instruments in parallel:[21] starting out from the basis of authorisation (single payment contract or framework contract and its interpretation, Articles 44–58), continuing with questions of unauthorised and even fraudulent initiation by third parties (Articles 59–63), then with revocation of authorisation (Article 66), included in the rules on execution via the interbank chain which follow (Articles 64–73), then continuing with the crediting of the amount to be paid to the beneficiary's account (Articles 70–73), and finally arriving at the sanctions in cases where duties in the interbank chain have been violated (Articles 75–78).

A fourth important feature is that of party autonomy. In fact, it is the combination with party autonomy which allows for the flexibility needed to apply

P. Massari, in K. Riesenhuber (ed), *Perspektiven des Europäischen Schuldvertragsrechts* (Berlin/New York: de Gruyter, 2008) 113, 118–120.

19 See the detailed statistics in: ECB, *Payment Statistics* Nov 2008, 17; available as well at ehttp://sdw.ecb.europa.eu/reports.do?node=1000001441; Press release 26 November 2008 – Statistics on payments and securities trading, clearing and settlement – data for 2007. Still clearer – for Germany – the table: ECB *Blue Book statistical update*, March 2006.

20 On this approach, for the PSD and the EU Consumer Credits Directive, see P. Derleder, 'Die vollharmonisierende Europäisierung des Rechts der Zahlungsdienste und des Verbraucherkredits' *Neue Juristische Wochenschrift* 2009, 3195; B. Gsell and M. Schellhase, 'Vollharmonisiertes Verbraucherkreditrecht – ein Vorbild für die weitere Europäische Angleichung des Verbraucherprivatrechts?' *Juristen-Zeitung* 2009, 20; T. Riehm and B. Schreindorfer, 'Das Harmonisierungskonzept der neuen Verbraucherkreditrichtlinie' *Gemeinschaftsprivatrecht* 2008, 244; and as well the broader analysis in B. Gsell and C. Herresthal (eds), *Vollharmonisierung im Privatrecht* (Tübingen: Mohr Siebeck, 2009).

21 Including often rules on the question of fees for the single steps: see art 31, 51 et seq, 65(2), 73(2) PSD; and, of course the Regulation (EC) N 2560/2001 of the European Parliament and the Council of 19 December 2001 on cross-border payments in Euro, *OJEC* 2001 L 344/13.

this rather strict overall approach – full harmonisation and 'horizontal' arrangement of the rules – to all payment instruments although these instruments, of course, differ to a certain extent in concept and therefore as well in legal treatment. In important aspects, party autonomy is accepted. This is so to a large extent in the relationship to professional clients and insofar as banks concede more favourable arrangements (Articles 51(1) and 86(3) PSD) and, more specifically, as well in consumer relationships in some particular points. An important point of this kind is that the moment until which an order can be revoked can be fixed autonomously within a payment scheme (Article 54(3), Article 66(5), see below section 2 a)). Thus, via standard contract terms or interbank agreements which are rendered applicable also in the relationship to clients, models can still be created that lie outside the directive to a considerable extent.

2 Some Paradigmatic Substantive Law Issues

In a survey like this one, it is impossible to give an account of the directive as a whole (for this, see literature in footnote 9). It is, however, helpful to give some core examples to illustrate the interplay of the features named and to do so for the different payment instruments in parallel – thus paying credit to the philosophy of the directive. Three moments are particularly meaningful, these are authorization (with revocation), third party fraud and execution in the interbank chain.

a) Authorisation and Revocation

The first example is authorisation and revocation. Given that execution has become increaslingly rapid, it seemed logical to reduce radically the period in which revocation is possible (Article 54(3), Article 66(1) PSD). In principle, revocation is excluded once the order has reached the first mandated bank. Traditionally revocation had been possible until the beneficiary's bank had received credit – this has been the solution under the EC Credit Transfer Directive of 1997. In some national laws, such as German Law, the period had been even more extended before. Revocation had been possible until the beneficiary himself had received credit. This reduction of the period must, however, also be seen in conjunction with the possibility to deviate via agreement, namely in particular transfer systems (Article 66(5) PSD). Thus arrangements can be made for each payment instrument which fit this instrument well. In fact, payments by cards are irrevocable under Article 66(2) PSD once the creditor has transferred the authorization by the debtor to the debtor's bank – the reason being that payments by debit or credit cards are designed for transactions where the creditor does not have a relationship of some confidence with the debtor and therefore needs to use a payment instrument which

is 'as good' as cash. Conversely, credit transfers are aimed at situations in which the creditor is confident that the debtor will initiate payment himself, typically when there is a relationship of some stability or at least knowledge of the debtor. Here the directive leaves it to the parties to decide which moment should be the one in which the right to revocation ceases, ie to leave this decision to the interbank agreements which install the payment scheme. And finally, direct debits are attractive in many countries mainly because, in situations where payment via the use of cards is excluded, they serve the needs of both sides: the creditor has the possibility to initiate payment on his own motion even when the debtor is not present, but at the same time the debtor is protected, because he or she can revoke the payment initiated by the creditor without particular reason. Only this arrangement giving debtors a strong right of discretion made them accept the direct debit at all and hereby also the possibility that the creditor can initiate the payment. This strong right of discretion makes up for the fact that in the case of this payment instrument, the debtor does not initiate payment (like in credit transfers) nor controls it (by tendering a card). Thus, in case of this payment instrument, the debtor would not have control of the payment made from his account if he did not have the right to revoke. That such right can be given to the client, although it should not exist for the other payment instruments, is the aim of Article 66(5) PSD. Thus the directive deals with the problem horizontally – for all payment instruments in one sole rule (Article 66 PSD). At the same time, the arrangement allows for all the flexibility needed for adapting – at the basis of party autonomy – the period of revocation to each instrument individually.

b) Authorisation and Third Party Fraud

In case of third party fraud, Articles 58–60 PSD prescribe that payments which the owner of the account did not authorise do not lead to a claim of the bank against the owner. They therefore do not justify that the account be charged (or charges already realised have to be corrected 'without undue delay').

This, however, is only the principle. The exception is laid down in Article 61 PSD. Under this rule, the owner of the account may be liable in some exceptional and narrowly defined cases. This rule explicitly refers only to payment instruments which are individualised as defined in Article 4 n 23 PSD. Thus the core distinction is between the use of individualised instruments and cases where *no such individualised instrument has been used*. In the latter case, there is no client's liability at all. Thus simple credit transfers not authorized by the account holder himself, but initiated by a third party without permission, do not give rise to any liability. This had already been the majority rule under national laws, because in such cases the account holder did not really cause the damages by negligent behaviour. Similarly, direct debits are not caught (where the right to revoke protects the debtor anyhow, as described above).

With respect to credit transfers, the only exception can be found where the client initiates them via home-banking using a PIN etc. Then again, an *individualised instrument* has been used. Thus for instance, cases of phishing can be caught, but are treated distinctly on a second level. The core case of such an individualised instrument is, of course, the use of *payment cards*. In this case, but as well in said cases of home-banking, the client is potentially liable, but typically to different degrees. That is because two kinds of liability have to be distinguished: a basic, lump-sum liability and full liability. The lump-sum liability is owed in all cases of fraudulent use of individualised instruments, the reasoning being the following: there should be the incentive for the client to apply a high standard of care. Therefore, not only does the directive prescribe care with respect to the instrument and a duty to report losses as quickly as possible (and on the bank's side systems which make such reporting easy) (see Article 56 et seq PSD), it also provides for a minimum liability of the client if the instrument has been lost and then used (Article 61(1) PSD). This minimum liability of 150 € is just important enough to serve as an incentive for being careful, at the same time application of the rule should be easy (not to undermine the incentive) and therefore does not require any negligence. This is a risk which any client can bear and which at the same time is capable of exercising disciplining effect. Full liability on the other hand requires gross negligence or fraud from the side of the client himself (Article 61(2) and (3) PSD). Again, this allows for adaptation to the different instruments because gross negligence is easier to establish if more security devices have been installed – for instance if the loss of a card has not been reported right away and the PIN has been used by the fraudulent third party. At this last step, full harmonisation is clearly missing – because political consensus could not be reached. The directive does not solve the question which is most disputed and practically most important in this situation, and this is whether in such a case gross negligence can be presumed or not.[22]

c) Duties and Responsibilities in the Interbank Chain

The core of the old directive of 1997 was already about execution within the interbank chain and about the duties and responsibilities flowing from it. Therefore, only two major steps were needed to complete harmonisation, and this was applying the regime also to purely domestic cases and applying the so-called 'money-back' guarantee without caps. This is the guarantee which the first mandated bank owes his client, the payer, to pay for all delays and losses within the chain, ie for all shortcomings in the interbank chain

22 The EC legislature would rather seem to refer this question still to national law (see recital n 33) – probably the one lacuna in the full harmonisation approach of this directive which practically is the most important.

(except those stemming from the beneficiary's bank). The caps (maximum amounts), in the old directive, above which the payer could only turn himself directly against the bank responsible in the chain (if national law allowed this) have now been abandoned.

This being decided, harmonisation, indeed full harmonisation, was relatively easy to be reached, namely because now the pure interbank relationships are at stake, ie regimes which already traditionally had been regulated in a uniform way in the legal arrangements of payment systems, and as well because party autonomy is accepted to a considerable extent (Articles 51(1), 52(1), 53(1), 54, 55, 64(2), 67(2), 68(2), 74(2), 76 PSD). Therefore such interbank arrangements are still possible. The core decisions are: the responsibility (for the whole chain) described arises from loss (irrespective of negligence, Articles 75, 77 PSD). This responsibility arises also if banks deduce their fees from the sum to be transferred (see Articles 49 et seq, 67 PSD; fees rather have to be charged separately in order to make the correct sum arrive at the beneficiary's account). And the responsibility arises from delay (again irrespective of negligence, Article 75 PSD). In this respect, however, reference is still made in part to national law (Article 76 PSD). In this respect, again a rather important change has occurred (as compared with the forerunner directive) and full harmonisation has a firm grip. This is because now the terms within which execution has to occur have been fixed: they have been considerably shortened and, in addition, they are largely mandatory (Articles 68–73 PSD). They apply, however, to their full extent and with the very short terms only to (all) payments in Euro or domestic payments in countries with other currencies (after a certain period of transition).

III EU Consumer Credit Directive

The second important legislative measure in European Contract Law since the last report is the new EU Consumer Credit Directive, adopted in spring 2008.[23] It is much less innovative and departs much less from what had been

23 Directive 2008/48/EC of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC [Consumer Credit Directive], *OJEC* 2008 L 133/66; for this measure see P. Rott, 'Die neue Verbraucherkredit-Richtlinie 2008/48/EG und ihre Auswirkungen auf das deutsche Recht' *Wertpapier-Mitteilungen* 2008, 1104; M. Siems, 'Die neue Verbraucherkreditrichtlinie und ihre Folgen' *Europäische Zeitschrift für Wirtschaftsrecht* 2008, 454; C. Hofmann, 'Die Pflicht zur Bewertung der Kreditwürdigkeit' *Neue Juristische Wochenschrift* 2010, 1782; C. Hofmann, 'Die neue Erläuterungspflicht des § 491a Abs. 3 BGB' *Zeitschrift für Bank- und Kapitalmarktrecht* 2010, 232; C. Hofmann, in Riesenhuber (ed), n 18 above, 71; J. Ady and E. Paetz, 'Die Umsetzung der Verbraucherkreditrichtlinie ins deutsche Recht und besondere verbraucherpolitische Aspekte' *Wertpapier-Mitteilungen*

known from the first generation directive (of 1986). The EC Consumer Credit Directive had in fact been the first to install a fully fledged information regime in European Contract Law (see below section 1) which has been integrated also in the new directive. Some of the gaps left by the old directive have been filled by the new one, but not all. Both directives extend the scope of application from traditional 'loans' to all 'credit' arrangements because they create equivalent risks, and the most important gaps in the scope of application – namely with respect to large scale credits, land related credits and mortgages – have been passed on from the first to the second directive. Therefore, the most striking feature in the new EU Consumer Credit Directive is one which has been proposed, but hardly implemented in the final version of the directive: the concept of responsible lending, going well beyond an information philosophy (see below section 2).

1 Information Model (Old and New Consumer Credit Directive)

The very nuanced system of information rights – standardised, more individualised, pre-contractual, in the contract itself – seems impressive and almost a bit exuberant.[24] The most important contents of information to be given would seem to be two, one of which is first to be found among the duties on pre-contractual information, the other among the contents of the contract. These are the information on the annual percentage rate of charge, defined in Article 3 lit i CCD 2008 and regulated in four separate instances (Article 4(2) lit c, Article 5(1) lit g, Article 10(2) lit g, Article 19 CCD 2008) and the information on the total costs of the credit to the consumer, defined in Article 3 lit g CCD 2008 (Article 10(2) lit g CCD 2008). In the 1986 directive these information requirements could be found 'together' earlier in the directive and appeared still more as 'parallel'. They are of such considerable importance from the perspective of consumers for the following reasons.

For the consumer, the core question is whether he can afford the credit at all. Therefore total credit costs (per year or month) form the starting point. In this respect, it is important that really all costs should be included; here consumers

2009, 1061; C. Herresthal, 'Die Verpflichtung zur Bewertung der Kreditwürdigkeit und zur angemessenen Erläuterung nach der neuen Verbraucherkreditrichtlinie 2008/48/EG' *Wertpapier-Mitteilungen* 2009, 1174.

24 For descriptions of the information model under the old directive see: S. Grundmann, 'European Contract Law(s) – of What Colour?' (2005) 1 *European Review of Contract Law* 184, at 198–201. And for descriptions under the new directive see: Rott, n 23 above, at 1108 et seq; Derleder, n 20 above, at 3199. For a comparison of the information duties in Consumer Credit Law in Europe and the US see C. Hofmann, 'Parallele Interessen und Pflichten im Kredit- und Wertpapierhandelsrecht – Reformbedarf im US-amerikanischen Kreditrecht zur Bekämpfung missbräuchlicher Vergabepraktiken' *Zeitschrift für Rechtsvergleichung* 2009, 126.

typically have shortfalls in information. Therefore *in relationship to the individual situation of the consumer*, the 'total costs of credit to the consumer' is the core information. These credit costs, however, develop differently according to how regularly the consumer pays the interest and makes the capital repayments. Delay causes interest rates to rise substantially. Total credit costs then can easily double. Therefore, only a part of the information needed was owed under the old directive if the total credit costs were to be specified only with respect to regular payment of all interests and pay-backs owed. This was a major lacuna in the information model. This lacuna has been filled to a certain extent, since the legislature of the new EC Consumer Credit Directive requires the creditor to specify the interest rates in case of delay and to warn that interest rates rise in the situation of a delay (Article 5(1) lit l and m, see as well recital 26). This information duty can, however, still be complied with in a completely standardized way, ie by handing over the European standard information set on consumer credits. Moreover, the warning can be rather weak. What is worse, a warning about the fact that interest rates can rise in case of delay is one thing (even if it is spelt out more dramatically than the directive requires); another thing would be the specification of the situations which statistically are most likely to bring about default, namely unemployment and divorce, and as well the calculation of the overall costs not only of the credit incurred now, but of all credits already incurred in conjunction with the new one. This more extensive thinking about and warning of the 'worst scenario' is still relatively weak and at least not explicit even in the new Directive.

On the other hand, it is in the interests of a consumer to recieve as well as good an offer for his needs as possible. This is no longer the question of the individual situation of the consumer, at least not primarily (although a better offer may reduce his costs and thus make this offer still fit whereas another one would be too expensive). This is rather a question of *comparison between different offers* – in order to choose the best or a good one. The core information which helps in this respect is the indication of the annual percentage rate of charge. Credits are products for which most data are simple to compare: the service is always the use of a sum of money, therefore the price is the most important factor, but it is not always easy to observe for consumers. This is because of the manifold costs influencing the overall price: interest rates themselves, initial costs related with the grant of the credit, costs for securities, costs for insurance, etc, some of which are owed just once, others dependent on the time span for which the credit is awarded. Subjecting all these costs to one formula only and then calculating one interest rate which reflects them all (for the term of the credit envisaged), renders the annual percentage rate of charge more easily visible and thus simplifies comparison of prices.

2 Beyond Information Duties?

Coming back to the lacunae described – lacunae with respect to the dangers of default, ie the individual situation of the consumer –, the core question is whether further duties exist under the new directive or would have been advisable. In fact, the hottest discussions during the prolonged negotiations about the new Consumer Credit Directive were on this issue. The question was whether a duty of responsible lending which the lender would owe to the consumer should be introduced.[25] The Commission included two aspects of such a duty: to recommend and potentially create the loan suited best to the consumer's needs, and to evaluate the creditworthiness of the consumer (see Article 9 of the proposal).[26]

Only the latter was implemented into the directive. The opposition to a duty on the creditor to investigate which form of credit suits the consumer best and to chose or create a financial product tailored to the consumer's needs was well justified. In order to be effective, the national implementation would have granted the consumer a right to damages for breach of this duty. These damages could have taken the form of acquitting the consumer from the obligation to repay the credit, because he should not have incurred the credit and with it the duty of repayment if properly monitored. Such a regime would have abolished the very principles of European contract law. The consumer would no longer have been enticed to make his decisions independently on an informed basis.[27]

However, the duty of the creditor to evaluate the creditworthiness of the consumer made it into the final version and is now laid down in Article 8 and recital 26 of the directive. Whereas it seems clear that the creditor is obliged to create an individualized calculation based on the declarations made by the consumer, it is arguable whether this outcome needs to be disclosed to the consumer or only to a public authority. The scope of the directive, how-

25 See, for instance: Y. Atamer, 'Duty of Responsible Lending', in S. Grundmann and Y. Atamer (eds), *Financial Services, Financial Crisis and General European Contract Law – Failure and Challenges of Contracting* (The Hague: Kluwer Law, forthcoming); J.-U. Franck, 'Bessere Kreditkonditionen für Verbraucher durch mehr Regulierung – zum Paradigmenwechsel im Vorschlag für eine neue Verbraucherkreditrichtlinie vor dem Hintergrund der ökonomischen Theorie' *Zeitschrift für Bankrecht und Bankwirtschaft* 2003, 334; K. Riesenhuber, 'Information – Beratung – Fürsorge. Kritische Bemerkungen zum Vorschlag einer neuen Verbraucherkreditrichtlinie' *Zeitschrift für Bankrecht und Bankwirtschaft* 2003, 325; Rott, n 23 above, at 1109.

26 Proposal for a Directive of the European Parliament and of the Council on the harmonisation of the laws, regulations and administrative provisions of the Member States concerning credit for consumers, COM(2002) 443 final.

27 For a comparison of the principle of responsible lending in the directive and the Commission proposal see Hofmann (*Zeitschrift für Bank- und Kapitalmarktrecht* 2010), n 23 above, at 233 et seq.

ever, argues in favour of the first. The very objective of the directive is to protect the consumers; the protection of the financial sector from systemic risks may be another motive, but certainly an inferior one. That explains why recital 27 speaks in fact of giving individualised advice.[28]

This raises further issues: is the creditor obliged to refuse the credit if the consumer's soundness is questionable? If the Commission's broad regime of responsible lending had been enacted, the answer would be yes. Given the approach of the directive, which continues the tradition of European contract law to provide the consumer with the information necessary to decide independently and to bear herself the consequences of her decision, the answer should rather be no. The conception of the directive argues in favour of a (mere) disclosure requirement. The creditor has the duty to inform the consumer about the result of the evaluation, to explain the risks according to Article 5 n 6 of the directive, and leave the decision to her.[29] If the consumer chooses to do so, she may take on a very risky credit engagement on an informed basis.

This interpretation is supported by the fact that Article 8 is now drafted very vaguely (and this has obviously been on purpose). The legislative history as well would seem to speak against a duty of the creditor to reject the consumer's demand for money. One of the core arguments against an extensive principle of responsible lending has been that there may not be much need for such a duty. Lenders would seem to have a substantial self-interest and thus typically enough incentive to be careful in taking on overly risky credit engagements. Besides, experience may well show that an overall strategy of granting risky credits can pay off for banks – even if many fail – if the interest rates and fees are high enough and that an excessive duty of responsible lending would push back such strategies and make loans unavailable in too many cases.

Much easier to evaluate is one last modification that the new directive made with respect to termination. Termination is possible at any time – both under the old and the new directive – if the credit is given for an indefinite term or during all those periods in which the interest rate is variable (Articles 13, 16(3) lit c CCD 2008). Thus if the lender is not bound with respect to all core conditions, the consumer should not be either. In addition, the old directive had given the consumer the right to terminate in any case after 10 years. The

28 On the highly controversial discussion in Germany where the legislator has established the duty to report to the supervisory authorities only see objecting Hofmann (*NJW* 2010), n 23 above, at 1783 et seq; Rott, n 23 above, at 1109 et seq; supporting Ady and Paetz, n 23 above, at 1067; Herresthal, n 23 above, at 1176.

29 On the duty of the creditor to place the consumer in a position enabling him to assess whether the proposed credit agreement is adapted to his needs and to his financial situation see Hofmann (*Zeitschrift für Bank- und Kapitalmarktrecht* 2010), n 23 above, 232–238.

new rule rather opts for a right to terminate at any time if the losses which the lender thus incurs are compensated (Article 16 CCD 2008, recitals 39 and 40) – requiring the lender to pass on to the consumer an adequate share of the savings made in case of early termination (see para 2 of the rule). This rule not only allows for termination well before the lapse of ten years, but as well renders it possible for consumers to get credit terms for more than ten years and potentially better interest rates in this case.

IV Further Development of the MiFID

The MiFID has been at the center of the last report, and has aroused considerable interest also in scholarly debate (see footnote 9). For contract law, one question has to be asked from the outset and this is to know how far the directive sets contract law standards or whether the standards are owed only to the supervisory authorities. While the ECJ has not ruled on this question yet, the German Civil Law Supreme Court (*Bundesgerichtshof*) has given its opinion. Traditionally the court had assumed an implied agency contract between providers of investment services and their clients under which the information duties and the duty to give best advice were owed; thus, in fact, the contents of Article 19 MiFID were seen as contractual standards. On the other hand, the court had not assumed that organisational duties, namely under Articles 13 and 18 MiFID, were owed as well to the clients, nor did the court assume this for documentation duties.[30] There is, however, important literature to the contrary. In a recent judgment, the court pronounced that even Article 19 MiFID (and its transposition) did not constitute rules designed to protect private law subjects.[31] This judgment has been interpreted by some authors further to restrict the importance of the MiFID as a contract law standard. The facts of the judgment show, however, that the court only wanted to protect mere representatives of investment services providers against personal liability (leaving the liability of the services provider untouched) and that it therefore did not accept a claim in tort. The judgment thus does not imply

30 See among others, for the duties in the client relationship: Bundesgerichtshof of 2 February 1982, *Neue Juristische Wochenschrift* 1983, 1730; Bundesgerichtshof of 8 May 2001, *Official Reports (BGHZ)* 147, 343, 348; Bundesgerichtshof of 28 June 2005, *Wertpapier-Mitteilungen* 2005, 1567, 1570; and for organisational standards and documentation: Bundesgerichtshof of 8 May 2001, *Official Reports (BGHZ)* 147, 343, 350; Bundesgerichtshof of 19 December 2006, *Neue Juristische Wochenschrift* 2007, 1876, 1878; for the literature and more case law: Grundmann, n 9 above, namely para VI 269 et seq, VI 320.

31 See Bundesgerichtshof of 19 February 2008, *Neue Juristische Wochenschrift* 2008, 1734. For a comparative law survey on the issue see O. Cherednyschenko, ‘Full Harmonisation of financial services law in the EU: a success or a failure?’, in Grundmann and Atamer, n 25 above.

any answer to the question whether and in how far the provider of investment services is bound by contract to the standards laid down in the MiFID. This is in fact the starting point, the regime under the directive is so detailed that many duties under contract law would be very much refined if indeed the directive applied in this context. In fact many duties, even quite detailed ones, have been found to bind as contractual standards under German Law, such as, for instance, the duty to disgorge kick-back payments.[32]

The second-level legislation in the Lamfalussy architecture deals with the following aspects. The Commission directive 2006/73/EC[33] defines numerous terms of the MiFID and clarifies the organizational requirements and operating conditions of the investment firms according to the requirements of the MiFID. The Commission Regulation (EC) No. 1287/2006[34] is also based on the MiFID. It mainly regulates the recordkeeping and reporting obligations of investment firms and clarifies the requirements for market transparency and for the admission of financial instruments to trading.

V Summary Considerations

EU Banking Contract Law, over the last half decade, has become the first area of European Contract Law where all core legislative measures are now in their second generation. Therefore it reflects much of the imminent 'future' of European Contract Law:[35] The extended scope of the directives and their thorough regulation bring about an advanced state of system building – one could even go so far and say 'mini-codification' –, most strikingly in the EU Payment Systems Directive, but as well in the EU Markets in Financial Instruments Directive. The combination of market regulation and contract law standards is paradigmatic for European Contract Law insofar as the combination

32 Bundesgerichtshof of 19 December 2000, *Official Reports (BGHZ)* 146, 235, 241; Bundesgerichtshof of 19 December 2006 and of 13 July 2004, *Neue Juristische Wochenschrift* 2007, 1876 and 2004, 3423, 3425 respectively.

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

34 Commission Regulation (EC) No. 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards 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.

35 More in detail on these overall characteristics of EU Banking Contract Law: S. Grundmann, 'European Law and Principles on Commercial and Investment Banking Contracts – An Advanced Area of Codification', in A.S. Hartkamp et al. (eds), *Towards a European Civil Code* (5th ed, Nijmegen: Kluwer Law, 2010); Grundmann and Atamer, n 25 above.

of regulatory parts and of – more classical – facilitative contract law becomes increasingly dense and insofar as the regulatory parts are increasingly important and integrated into modern contract law anyhow and in particular into modern European Contract Law. Therefore, the combination which, again, is particularly characteristic for both directives named, perhaps even more for the EU Markets in Financial Instruments Directive, is telling as well for modern European Contract Law in general. And finally, also the full harmonisation approach can probably best be studied in its effects in the three EU Banking Law Directives which, in fact, all three have more of this approach than virtually any other EU legal measure so far. In summary, EU Banking Contract Law appears more as a fully fledged Europeanized system – 'codified', facilitative and regulatory, and as well exclusive – than any other area of European Contract Law.