BETTER FINANCE
LEGAL COMMITTEE

BETTER FINANCE Working Paper 4

Targeted Comments on the Proposal for a Directive on

Representative Actions for the Protections of the Collective Interests of Consumers

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BETTER FINANCE, the European Federation of Investors and Financial Services Users, is the public interest non-governmental organisation advocating and defending the interests of European citizens as financial services users at the European level to lawmakers and the public in order to promote research, information and training on investments, savings and personal finances. It is the one and only European-level organisation solely dedicated to the representation of individual investors, savers and other financial services users.

BETTER FINANCE acts as an independent financial expertise and advocacy centre to the direct benefit of European financial services users. Since the BETTER FINANCE constituency includes individual and small shareholders, fund and retail investors, savers, pension fund participants, life insurance policy holders, borrowers, and other stakeholders who are independent from the financial industry, it has the best interests of all European citizens at heart. As such its activities are supported by the European Union since 2012.

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This Working Paper provides a targeted analysis on several provisions of the European Commission's (EC) *Proposal for a Directive of the European Parliament and of the Council on*

representative actions for the protection of the collective interests of consumers, and repealing Directive 2009/22/EC,[24] hereinafter 'Collective Redress Directive' or 'CRD'. Certain rules are key on defining a robust and effective mechanism for consumer redress, while also striking a fair balance between the diverging interests and avoiding abusive litigation.

The Collective Redress Directive must reflect the EU innovative approach and create a mechanism that ensures a high level of consumer (Art. 38 Charter of Fundamental Rights), equal conditions for access to justice (Art. 67 Treaty on the Functioning of the European Union) for the entire spectrum of consumers in the EU, including investors and financial services users.

Below we lay arguments explaining why financial services users are the most vulnerable category of **consumers**.

Financial services users as consumers – Article 3(1)

The purpose of the collective redress mechanism is to serve EU citizens in their capacity as consumers on a cross-sectorial and cross-border basis. However, there have been debates on whether financial services users, such as investors, shareowners, bondholders, life insurance policy holders etc., qualify as consumers or not.

The current text of Directive contains, in Article 3(1), the definition of a consumer, specifying:

> *(1) 'consumer' means any natural person who is acting for purposes which are outside their trade, business, craft or profession;*

This definition follows the line of other EU consumer protection acts[25] and revolves around the nature and scope of a contract in qualifying a person as a consumer. Albeit the EU financial framework uses a different, specific, legal terminology for qualifying the non-professional counterparties – individual investors, life insurance policy holders, retail clients, savers – the latter are no less consumers than air passengers, for instance.

This finding is based on the (I.) *rationale of consumer protection law*, the (II.) *nature* and (III.) *purpose* of consumer contracts, the (IV.) *characteristics of financial services or products* and the (V.) need to acknowledge the *equivalence of terminology*, elaborated below.

[24] COM/2018/0184 final - 2018/089 (COD).

[25] See Article 3(12) of Regulation (EU) 2017/2394 of the European Parliament and of the Council of 12 December 2017 on cooperation between national authorities responsible for the enforcement of consumer protection laws and repealing Regulation (EC) No 2006/2004, OJ L345/1; Article 17(1) of Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 351, 20.12.2012, p. 1–32; Article 2(b) of Council Directive 93/13/EEC of 5 April 1993 on unfair terms in consumer contracts, OJ L 95, 21.4.1993, p. 29–34; Article 3(a) Directive 2008/48/CE of the European Parliament and of the Council of 23 April 2008 on credit agreements for consumers and repealing Council Directive 87/102/EEC, OJ L 133/66.

I. *Rationale of consumer protection*

The reasoning starts from the premise that consumer protection law has a derogatory nature (*lex specialis*) from common law due to the unequal position of consumers in legal relationships with traders. The unequal position is in turn explained by several factors affecting consumers: (i) lack of specific knowledge; (ii) the lack of resources, financial and material; (iii) lack of experience in a sector of activity; and, many times, (iv) the reduced value (monetary or patrimonial) of the legal relationships. These factors trigger two practical effects:

- First, a significant ***imbalance*** in the negotiation power ***between the consumer and trader***;
- Second, but most important, the consumer's ***passive behaviour***.

These factors are used to justify the need for extra protection of consumers, the case at hand being an attractive, flexible and practically efficient redress mechanism. However, the rationale goes even beyond the need to protect consumers, as the Working Group on 'Parties' of UNIDROIT and the European Law Institute (ELI) obliterates the concept of 'consumer' for collective redress and acknowledges the necessity to assess and adjudicate jointly cases where: such procedure would make dispute resolution more efficient; all claims arise from the save event or legal relationship; and the claims are similar.

Notwithstanding the following reasoning, the inclusion of financial services users under the scope of a pan-EU collective redress mechanism should not, by principle, keep account of whether the former qualify or not as consumers. Nevertheless, the following reasoning will assume that collective redress is only possible for consumers.

II. *Nature of a contract – acting outside a trade or profession*

EU law qualifies a party to a contract as a consumer based on the context and capacity in which he or she concludes the contract (*nature*), finding which was validated by the Court of Justice of the EU[26] ("CJEU") and by Advocate-General Tanchev in a recent preliminary reference proceeding before the CJEU.[27] This explicit criterion leaves small room for interpretation, referring only to the *objective situation* of a person, and is not anchored in his or her behaviour, level of knowledge, expertise or degree of risks assumed.[28]

In other words, the CJEU explained that the nature of the contract must mean that the legal relationship for the consumer arises "*in the course of activities outside of a trade, business or profession*",[29] since the assessment must take into consideration the objective nature of the concept of consumer.[30]

The CJEU upheld this reasoning in interpreting the same definition of a consumer in different provisions of EU law relating to consumers or consumer contracts.[31] It is therefore evident that the construction "*acting for purposes outside his trade or profession*" creates an absolute assumption (*juris et de jure*) that a person will qualify as a consumer whenever he or she concludes

[26] Case C-375/13 *Harald Kolassa* v *Barclays Bank plc*, ECLI:EU:C:2015:37, para 23.
[27] Opinion of AG Tanchev in Case C-208/18 *Petruchova* v *FIBO*, ECLI:EU:C:2019:314, para 46.
[28] See Ibid, para 47; see also Case C-498/16 *Maximillian Schrems* v *Facebook Ireland Ltd*, ECLI:EU:C:2018:37, para 39; Order of the Court in Case C-74/15 *Tarcau* v *Intesa Sanpaolo*, ECLI:EU:C:2015:772, para 23.
[29] Case C-74/15 *Tarcau* v *Intesa Sanpaolo* (n 5) para 27 ; see also Case C-534/15 *Dumitras vs BRD Groupe Societe Generale*, ECLI:EU:2016:700, para 30.
[30] Case C-110/14 *Horatiu Ovidiu Costea* v *SC Volksbank Romania*, EU:C:2015:538, para 21.
[31] Such as the Unfair Terms Directive (93/13/EC), the Rome I Regulation (1215/2012), or the Brussels I Convention/Regulation (593/2008) – see also Case C-348/14 *Maria Bucura* v *Bancpost*, ECLI:EU:C:2015:447;

a contract with a professional or trader in a context that is not related to the person's trade or profession.

Although, according to the settled case law of the CJEU, the above explanations are sufficient to determine in abstract when is a party to a contract a consumer, below we refer to additional arguments *de lege ferenda* to justify why financial services users are consumers and maintain this status.

III. *Purpose of the contract – obtaining a profit*

As per the definition in Article 3(1) of the proposed Directive, one must analyse also the purpose of consumer contracts. From the traders' point of view, the purpose of concluding a contract is undoubtedly to obtain a profit. Conversely, from a consumer perspective, although the immediate purpose (*causa proxima*) is that of consumption, on the short- or long-term, depending on the nature of the product or service, the indirect purpose of a contract (*causa remota*) is also that of **achieving a profit**. This is explained by the general theory of commerce, by which a trade is no longer rational if a contracting party could procure the good or service on its own account at a lower cost of resources than that charged by the seller of the good or service.

If one were to make a distinction of contracts by their intended purpose, these would be divided into gratifications (donations, wills, free leases) and beneficial contracts, where both parties aim to obtain a patrimonial benefit in exchange of performing an obligation.

In general, gratification contracts are not only subject to different legal branches (such as inheritance law), but the rationale behind consumer law no longer applies as the consumer is by default gratified and does not incur the performance of any obligation he or she is not able to negotiate or assume.

Therefore, it must be concluded at this point that **a consumer always pursues obtaining a profit** as well by concluding a contract with a trader, in addition or adjacently to the purpose of consumption. As such, in financial services and capital markets, **retail investors must qualify as consumers** in spite of the fact that they pursue a speculative purpose or not.

IV. *Characteristics of financial products or services*

BETTER FINANCE contends that financial services users are one of the most vulnerable categories of consumers, due to the exceptional nature and characteristics of financial services and products.

> "*We don't expect people to design and build their own cars. We do it for them, in a way that makes the technology so transparent that a 16-year-old can use it. The same goes for computers and all of the other important instruments of daily life. Why is saving and dissaving* […] *so "special" that it requires us to educate ourselves — and protect ourselves from fraud and misinformation — in a field for which most of us have no aptitude?*"[32]

Capital markets structures and investment products have grown so much in complexity that bare mathematical or financial knowledge are by far insufficient as to allow individuals to

[32] Foreword by Laurence B. Siegel for a Research Paper on Financial Education and Consumer Protection, see Research Foundation of the CFA Institute, 'Life-cycle Investing: Financial Education and Consumer Protection', editors Laurence B. Siegel, Zvi Bodie, Laura Stanton, (2012), vii, https://www.cfainstitute.org/-/media/documents/book/rf-publication/2012/rf-v2012-n3-full-pdf.ashx.

make an informed decision, consider risks and assume obligations on an equal position as professionals. Therefore, why they not benefit of a special protection as all other consumers?

Academic literature even submits that, out of the three categories of consumers – based on the abstract type of product purchased – financial services users have the weakest position, since investment products:

- Can neither be tested after purchase ("*experience goods*");
- Nor can they be verified beforehand ("*searchable goods*").[33]

What is more, surveys researching the level of basic financial literacy of the adult population in the EU have shown that less than half (49.86%), on average, have the correct answer to at least three out of four simple questions relating to finance: inflation, numeracy, risk diversification and compounding.[34]

It is even worse, considering that academics and researchers in behavioral finance observed that retail investors tend to underestimate risks, emphasize positive returns or overestimate their ability to predict returns, even apply "*hyperbolic discounting of future costs*".[35]

It follows that it is crucial that retail investors place their confidence in the investment advice received and in the best execution of financial services providers for the purpose of investing,[36] which they must receive additional protection and accessible conditions for redress than other investors, in general.

Therefore, the abovementioned considerations all the more strengthen the reasons to qualify retail financial services users as consumers, irrespective of the specific terminology used to describe the objective capacity in a contract (creditor, debtor, guarantor, investor, saver, insured etc).

V. *Equivalence of terminology*

The arguments presented above (I-IV) explain why retail financial services users must be considered a consumer on the basis of its objective and subjective conditions. Nevertheless, in order to avoid divergent interpretation and application of the law, the EU co-legislators must acknowledge the equivalence of the specific terminology used in EU consumer protection law and EU financial regulation. Based on a short query on the CJEU website, 62% of most recent preliminary references in the category "consumer protection" concern financial services, capital markets or financial institutions only.

The issue at stake is that MiFID II makes a distinction between professional and retail "clients" of investment services providers. Although there is no legally binding connection or reference between what MiFID considers "retail" and what consumer protection law considers "consumers", terminology should not impede qualification as the assessment must be made on the *objective nature and purpose*, not on wording.

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[33] David Merenda, 'Protection of Retail Investors' (6 December 2018) Prague Law Working Papers Series 2018/III/1, p. 2.
[34] Own calculations based on Leora Klapper, Anamaria Lusardi, Peter van Oudeheusden, 'Financial Literacy Around the World: Insights from the Standard & Poor's Ratings Services - Global Financial Literacy Survey" (2014).
[35] See Merenda (n 10) p. 4.
[36] See Niamh Moloney, *How to Protect Investors* (2010) Cambridge University Press, p. 85.