

Guest Editorial

This issue of the *European Business Organization Law Review* is devoted to fundamental problems in the field of retail financial services as have become particularly clear since the recent disruption of the financial markets. Ultimately, these issues lead to line-drawing problems and policy choices about investor and consumer protection which are tackled from a legal and an economic perspective respectively. The articles in this issue have originated from papers and proceedings of the joint IMFS (Institute for Monetary and Financial Stability) and LEMF (Doctorate/PhD Program ‘Law and Economics of Money and Finance’) conference on ‘Retail Financial Services after the Crisis: Legal and Economic Perspectives on Investor and Consumer Protection’, which took place at the House of Finance, Goethe University of Frankfurt on 20 and 21 January 2012.

As organisers of the conference, we are proud and delighted that so many leading capital market experts from Europe and the United States agreed to present a paper and participate in the ensuing very lively discussions, thus contributing to a highly fruitful intellectual exchange. This deserves mentioning even more so because the conference not only presented an interdisciplinary challenge, but also endeavoured to integrate and face important policy questions giving direction to further developments in the retail financial sector over the next decade. In order to pave the way for an interdisciplinary debate and a dialogue between research and policy with a view to possibly providing regulatory answers, we held an opening panel discussion, laying out the policy questions faced by regulators in the field of retail financial services today. Subsequently, we grouped speakers from economics and law together in separate panels to look at the topics from different angles. Last but not least, we considered this area of research particularly well suited to introduce our doctoral and PhD students in law and economics to interesting issues of current research, trying to further the intellectual exchange between disciplines at the House of Finance at the Goethe University of Frankfurt and to gather the students around this cutting-edge research agenda. In light of the necessary additional effort and openness, we would therefore like to take this opportunity to thank everybody again for their support. We would also like to express our gratitude for the financial support of the ERC (Advanced) Grant 2008 (No. 229921) and that of the House of Finance at the Goethe University of Frankfurt, and for the most generous grant of the *Stiftung Geld und Währung* that makes the entire doctorate/PhD program possible.

Retail financial services markets are characterised by classic problems of market failures, information asymmetries probably being the most important among them. It therefore comes as no surprise that European financial market regulation has centred on information and disclosure duties, such as the Prospectus Directive 2003/71/EC (recently amended by Directive 2010/73/EU of 24 November 2010, OJL 327/1), the Market Abuse Directive 2003/6/EC, and Directive 2001/34/EC on the admission of securities to official stock exchange listing and on information to be published on these

securities. This EU regulation is primarily aimed at ensuring complete, efficient and transparent capital markets, thus reflecting an equilibrium-based efficiency concept as its foundation. In a similar way, harmonisation in the area of financial services has focused on the reduction of transaction costs by implementing the Internal Market and eliminating barriers to cross-border trading. While the Investment Services Directive of 1993 takes the freedom to provide services as its point of departure, the market-shaping force of the follow-up Markets in Financial Instruments Directive (MiFID) of 2004 becomes more apparent from its multidimensional regulatory approach directly aimed at trading places and contract relations.

Alongside the already existing information model, the MiFID has introduced a supervisory regime trying to bridge the gap between the ideal of party autonomy underlying the internal market and necessary protection for retail clients in the investor/adviser relationship. However, the objective of the MiFID to enable retail clients to 'take investment decisions on an informed basis' (Art. 19, para. 3 MiFID) highlights the pre-eminent role attributed to investor self-determination under this regulatory framework. At the same time, the findings of behavioural economics have increasingly gained influence in the regulatory debate. Therefore the, by now, well-known boundaries of human rationality have made the expansive disclosure regime seem only limitedly useful. In particular the recent financial crisis has demonstrated how overoptimism and overconfidence may lead to excessive trading, which had become more and more important for financial institutions. In fact, this change in paradigm is reflected by the proposals set out in the review of the MiFID (MiFID II) which is marked not only by disclosure reform but also by a regulatory shift towards giving the regulators the ability to ban products.

Notwithstanding the plausibility of behaviourally based reasoning and the need for reform, these assumptions are not beyond doubt either. Reliance on *ad hoc* models explaining specific stylised facts and the failure to provide a general theory are the common criticisms raised against behaviourally inspired arguments. Closely tied to this line of reasoning is the objection to expansive disclosure regulations, implying that users of information are limited in their ability to distinguish useful from useless information and to actually make use of the information to reach optimal decisions. Considering the resulting lack of robust predictions that policy-making can rely on, the door is wide open to debate about both the underlying assumptions and the ensuing regulatory framework and its ultimate enforcement.

This has been the forward-looking starting point of the conference papers and proceedings for improved research on retail financial services and its contribution to a fruitful regulatory debate. It becomes particularly clear in the opening statement 'Consumer Protection in the EU: Searching for the Real Consumer', presented by Jacqueline Minor, on the approach taken by the European Commission's Directorate-General for Health and Consumers (DG SANCO) to investigate the way real people behave in the real financial market. She refers to studies undertaken by DG SANCO that are well suited to illustrate the distortion of consumer preferences, their biases in decision-making and the resulting regulatory policies. DG SANCO not only has to clarify its basic assumptions, but also faces as yet open enforcement issues.

The regulatory shift towards consumer protection is traced back to its underlying assumptions in the next paper, authored by Niamh Moloney. In 'The Investor Model Underlying the EU's Investor Protection Regime: Consumers or Investors?', Niamh Moloney pursues the question of how to characterise the retail client, analysing pre-crisis as well as crisis-era EU regulatory policy. Her proposition is that a new investor model has taken centre stage in the aftermath of the global financial crisis. As she shows in her paper, the formerly dominating model of the autonomous retail investor relied on a regulatory regime primarily based on disclosure and distribution rules. However, in light of intensified criticism against this model of an empowered and autonomous investor throughout the financial crisis, this concept is now being replaced by an approach towards the retail client as a consumer of financial products and services. As a result of the consumerisation of EU regulation of retail financial services, a product intervention regime is shown to emerge.

Luigi Guiso's paper 'Trust and Risk Aversion in the Aftermath of the Great Recession' then draws the attention to the empirical basis of retail clients' behaviour and their decisions during the financial crisis. The two major features highlighted in his analysis are the dramatic drop in people's trust in financial markets and the massive increase in investors' risk aversion. In addition to the connection between opportunism and fraud that have become apparent during the financial crisis and the ensuing drop in trust on the part of investors, the author establishes another link between the dramatic drop in trust and a tremendous and long-lasting increase in investors' risk aversion during the crisis. The resulting slowness of recovery stands to reason, so that the author's finding of enduring consequences of the financial crisis seems the logical outcome of the comprehensive data presented in his paper.

The pre-eminent role of the European financial regulatory regime notwithstanding, civil law instruments continue to play an important role with regard to efficient investor protection, which is the subject of Susanne Kalss' article 'Civil Law Protection of Investors in Austria – A Situation Report from Amidst a Wave of Investor Lawsuits'. At the example of Austrian courts' responses to the more than 22,500 investor lawsuits, the author highlights the complementarity of civil law and modern supervisory law implementing EU directives, exemplified by the crucial role of contract law in investor lawsuits. Contract law rules have had to cope with the task of categorising investments by retail clients based on advice as well as on sales brochures in their conceptual framework. At the same time, the sheer number of lawsuits has forced judicial practice to adopt 'Austrian-style class actions' in order to cope with these masses of claims based on similar facts. Thus, the financial crisis has turned out to be a trigger not only for regulatory reform but also for doctrinal developments in civil capital market law.

Financial advice that is often the source of the lawsuits analysed in the previous article is more closely looked at from an economic perspective in the following contribution by Roman Inderst and Marco Ottaviani 'Regulating Financial Advice'. In light of the difficult investment choices to be made by consumers, the important role of professional advice is obvious, associated with the danger of mis-selling resulting from distorted incentives on the part of the advisers. A key to understanding

the reason for mis-selling is comprehending the underlying conflicts of interest. By allowing for consumer naiveté in their model and distinguishing between naïve and wary consumers, Inderst and Ottaviani demonstrate differences in efficiency flowing from disclosure. As a result, line-drawing problems have to be taken into account when it comes to policy interventions, which have to differentiate according to consumers' awareness of conflicts of interest.

Mis-selling in its various forms that results from the fast-paced innovative process in the financial industry is the subject of Eilis Ferran's article 'Regulatory Lessons from the Payment Protection Insurance Mis-selling Scandal in the UK', illustrating mis-selling at the example of the payment protection insurance (PPI) mis-selling scandal which occurred in the UK, and the challenge of how to design adequate regulatory responses. Retail investors are exposed to the downside of innovative processes when it comes to the marketing of newly developed financial products. In her paper, Eilis Ferran scrutinises the regulatory responses of the Financial Services Authority in PPI-related enforcement proceedings in terms of credible deterrence and consumer redress. This analysis paves the way for her evaluation of an appropriate regulatory policy to be pursued by the Financial Conduct Authority that is currently expected to be established in 2013.

Another reference to regulatory intervention is made in the case note authored by one of our doctoral students, Jacob Bonavita, analysing a recent decision by the German Federal Court of Justice of 2011 on the liability of a German bank acting as adviser to a medium-sized company. The author highlights how the Court's decision imposing prohibitive fiduciary duties on the bank amounts to a *de facto* product ban, which is not explicitly provided for by the information model of regulation.

The broad range of the papers and their interdisciplinary approaches reflect the multitude of problems and their solutions studied in the field of retail financial services, which have to be addressed with particular urgency in light of the recent financial crisis. It should also become clear that suitable solution strategies will require a careful economic analysis of the problem and a well-balanced regulatory approach to deal with it. We think that the papers published in this volume clearly show how to enter into such a fruitful interdisciplinary dialogue and we hope that they will be able to contribute to today's debate about reform in the field of retail financial services.

Last but not least, we would like to express our gratitude to T.M.C. Asser Press and to Priv.-Doz. Dr Rainer Kulms, Editor-in-Chief of EBOR, for their support and willingness to publish the results of our conference.

*Brigitte Haar**
*Roman Inderst***

* Professor of Law and Director of the Doctorate/PhD program 'Law and Economics of Money and Finance' at the Goethe University of Frankfurt.

** Professor of Finance and Economics, Endowed Chair of the *Stiftung Geld und Währung* at the Goethe University of Frankfurt.