

Regulating Investor Protection under EU Law

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The Unbridgeable Gaps with the U.S.
and the Way Forward

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To Valentina, in her loving memory.

Preface

This book analyzes the legal system for the protection of retail investors under the European Union law of investment services. It identifies the regulatory leitmotiv driving the EU lawmaker and ascertains whether and to what extent such a system is self-sufficient, using a set of EU-made and EU-enforced rules essentially different and autonomous from the Member States' legal orders.

The book takes a double perspective: comparative and intra-firm. Given the federal dimension of the US legal system and, thus, the “role-model” it plays vis-à-vis the EU, the book compares the two systems. The *Union/Federal* level as such— that is, detached from the national (in EU terms) and state (in US terms) level—is taken into account in order to fully highlight the existing gaps and measure the completeness/self-sufficiency of the EU system against its American counterpart. Alongside this, the book brings to the table the unique perspective of a European investment firm and analyzes how EU-produced public-law conduct-of-business¹ rules become a set of compliance requirements for investment services providers. This “within-the-firm” perspective is taken into account to gauge the completeness/self-sufficiency of the EU system of retail investor protection from the standpoint of an EU-regulated entity.

The book opens by positing the hypothesis, namely, that the EU lawmaker—interested in morphing the traditionally bank-based financial market of Continental Europe into a market-based financial system like

that of the United States—uses public-law conduct-of-business rules to adapt relationships traditionally regulated by private law to the new market infrastructure without, anyhow, paying enough attention to the private enforcement of such rules. The analysis leverages on the European Regulatory Private Law theory which makes it possible to highlight the regulatory nature of EU law and the current path leading toward a formal Americanization of the law and, at the same time, to a substantial centralization of regulatory and enforcement powers at EU level.

After setting the scene, the book is shaped into two main pillars: *the law-on-the-books*, that is, investor protection in the texts; and *the law-in-action*, that is, the enforcement² of investor protection rules on the part of public and private actors, and the practice of transposition of such rules into investment firms³ for which the internal Compliance Function is in charge. The first Part provides the reader with an illustrative breakdown and an evolutionary analysis of the European statutes dealing with financial services. The aim is twofold: on the one hand, it highlights the functional role that the retail investor plays in the EU Law of financial services within the context of the construction of an EU-wide market-based financial system and the related introduction of specific—increasingly detailing—public-law rules. On the other hand, it flags—by giving concrete examples—how the *law-on-the-books* becomes a set of regulatory requirements for investment firms with the result of making the Compliance Function a central figure within the firms (overcoming/mitigating inefficiencies at the *micro* level with a broader view of contributing to market efficiency at the *macro* level). The first Part subsequently compares the client-service provider relationship under the EU and US laws in order to test to what extent the two systems share similar patterns and verify whether and to what extent the US blueprint may be reproducible in Europe.

Subsequently, the first two chapters of the second Part analyze the legal tools provided by Union/Federal law for public and private enforcement and draw the attention to the fashion public and private mechanisms interact with one another. The purpose is not to examine the procedural elements of enforcement processes, but to assess whether the EU lawmaker prefers one set of tools over the other (private *vs.* public), to ascertain to what extent the American enforcement framework may be reproducible in Europe, and to identify the current trend of centraliza-

tion at the European level. The conclusive chapter, by taking a within-the-firm approach, is devoted to analyzing the role played by the Compliance Function, designed to fill the vacuum between the law-on-the-books and the law-in-action directly *within* a firm. This Function has emerged as the “embedder” of public-law rules into an investment firm and as a “frontliner” of enforcement of such public-law rules, due to its activities of regulatory advice, internal monitoring and reporting, and oversight of complaints-handling procedures, particularly relevant for very minor infringements that can be solved *within* the firm.

The conclusions show how the choice made by the EU lawmakers—that is, preference of the market-based over the bank-based financial system—(in)directly leads to a formal Americanization of the regulatory leitmotif of the EU law of investor protection. However, the EU system is incomplete when being compared to the US one due to the fact that the EU has neither a single common-law contract tradition nor a federal system of public (but a process of public enforcement centralization has been kicked off) and, in particular, private enforcement (where only national-based remedies and procedures can be employed). Despite that, when viewed through the lenses of a European investment firm and, in particular, its Compliance Function, the EU law of investor protection already fully develops its norms and quasi-independently enforces such norms through mechanisms it has itself provided (intra-firm complaints-handling; extra-judicial mechanisms; centralized enforcement powers). The result is the emergence of a European *Regulatory Investor Protection Law* that imposes a full set of regulatory requirements on financial firms to resemble—without, anyhow, yet gaining the full structure of—a self-sufficient system.

The book takes into account legislation as of July 2017. The views expressed in the book are those of the author and do not necessarily represent the views of his current and/or past employers.

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Notes

1. Conduct-of-business regulation “governs the conduct of financial intermediaries in providing financial products and services”. Andrew Tuch, “Conduct of Business Regulation,” in *The Oxford Handbook of Financial Regulation*, ed. Niamh Moloney, Eilís Ferran, and Jennifer Payne (Oxford: Oxford University Press, 2015). At 538. In their seminal book, Professors Grundmann and Glasow also define this as *Best Practice Rules for Intermediaries*. Stefan Grundmann and Falko Glasow, *European Company Law: Organization, Finance and Capital Markets—2nd Edition* (Cambridge: Intersentia, 2012). At 525–540.
 Prudential regulation, instead, deals with financial stability: “Micro prudential regulation concerns itself with the stability of each individual institution. Macro-prudential regulation concerns itself with the stability of the financial system as a whole.” Centre for Economic Policy Research, “The Fundamental Principles of Financial Regulation—Geneva Reports on the World Economy 11,” ed. International Center for Monetary and Banking Studies (2009). At xvi.
2. Within the context of this book, “private enforcement mechanisms” englobe the enforcement actions brought by private parties—either individually or collectively—before civil courts and Alternative Dispute Resolution schemes such as arbitration. On the other side of the spectrum, “public enforcement mechanisms” englobe the enforcement actions brought by public supervisory authorities. The word “supervision” stands for the public activity of authorizing and monitoring private market players, which very often englobes enforcement actions to sanction supervisees for their wrongdoings.
3. The “transposition of rules into investment firms” means the transformation of extra-firm rules (legal norms produced by the public rulemakers) into intra-firm rules (internal compliance requirements).

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List of Abbreviations

ADR	Alternative Dispute Resolution
CONSOB	Commissione Nazionale per le Società e la Borsa
EBA	European Banking Authority
ECJ	Court of Justice of the European Union
EIOPA	European Insurance and Occupational Pensions Authority
ESMA	European Securities and Markets Authority
EU	European Union
FIN-NET	Consumer Complaints Network for Financial Services
FINRA	Financial Industry Regulatory Authority
IAA	Investment Advisers Act
MiFID I	Markets in Financial Instruments Directive I
MiFID II	Markets in Financial Instruments Directive II
MiFIR	Markets in Financial Instruments Regulation
PG	Product Governance
SA	Securities Act
SEA	Securities Exchange Act
SEC	Securities and Exchange Commission
UCITS	Undertakings for Collective Investment in Transferable Securities
US	United States

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