Common Market Law Review **52**: 1579–1616, 2015.

EUROPEAN BANKING, SECURITIES AND INSURANCE LAW: CUTTING THROUGH SECTORAL LINES?

VEERLE COLAERT*

Abstract

Financial law and supervision are to a large extent divided into three separate branches – banking, securities and insurance – reflecting the three traditional sectors of the financial industry. The end of the 20th century has however been characterized by a blurring of distinctions between the traditional sectors and the services and products they offer. This contribution examines and evaluates recent changes in supervisory structure and in investor protection legislation intended to remedy the problems associated with this blurring of sectors. The shortcomings which are brought to light allow to draw conclusions with respect to two more fundamental and highly interdependent questions: (i) what is the adequate level and model of financial supervision in the EU, and (ii) what is the adequate level and model of financial legislation in the EU.

1. Introduction

Financial law as we know it today mirrors the traditional structure of the financial industry. It is thus divided into banking, insurance and securities law in most legal systems, be they international,[1] European[2] or national.[3] The end of the 20th century has however been characterized by a blurring of

* Financial law professor, KU Leuven. An earlier draft of this contribution was presented at the 2015 Comparative Law and Economics Forum (CLEF) meeting held in Leuven and Ghent on 12 and 13 June 2015. I would like to thank the participants for their critical questions. I further thank Herman Cousy and Maarten Peeters for their helpful comments.

1. With the Basel Committee on Banking Supervision issuing standards for the banking sector, the International Association of Insurance Supervisors (IAIS) for the insurance sector and the International Organization of Securities Commissions (IOSCO) for the investment services sector.

2. Cf. Financial Services Committee, "Report of the FSC on Long-Term Supervisory Issues", FSC 4162/08, March 2008, para 92: "Whilst the distinction along the traditional sectoral lines between business and products becomes more difficult to make, regulation in the EU is still largely organized along these lines".

3. With the notable exception of the Netherlands, which, with the Act of 28 Sept. 2006 on financial supervision, introduced one overarching piece of legislation for the three sectors.

distinctions between the traditional sectors. As the contours of the traditional tripartition in the financial industry have faded, the diverging regulatory and supervisory treatment of these sectors is increasingly at odds with the economic reality. This causes certain marked inefficiencies (see section 2.2).

Therefore several countries decided, in a first phase, to adapt their financial *supervision* structure. As this proved insufficient to solve the problems associated with the blurring of sectors, in a second phase the strictly sectoral approach to financial *legislation* has also begun to founder. After several Member States started experimenting with a more cross-sectoral approach to (parts of) financial legislation, the European legislature implemented a number of cross-sectoral initiatives at EU level.

Much research has already been done on the recent changes in the European supervisory structure and in EU financial legislation. This contribution seeks to take a helicopter view and evaluate both the developments and the interaction between them from the perspective of the extent to which they remedy the problems associated with the blurring of sectors. The shortcomings which are identified allow conclusions to be drawn with respect to two fundamental and highly interdependent questions: (i) what is the adequate level and model of financial supervision in the EU, and (ii) what is the adequate level and model of financial legislation in the EU.

This contribution will first discuss the problems stemming from a sectorally structured financial legislation and supervision in a financial industry characterized by a blurring of distinctions between the traditional sectors (section 2). The recent evolution in Europe's supervisory structure (both at Member State and EU level) is subsequently examined from this perspective in section 3. Section 4 explores some recent European legislative initiatives in the field of investor protection, which cut across the sectoral structure of financial legislation. Sections 3 and 4 form the basis for a critical appraisal of the more adequate level and model of legislation and supervision in the EU (section 5).

2. Financial law organized along sectoral lines: An outdated model

2.1. *Historical roots of sectorally divided financial law*

The traditional division of financial law into three branches, banking, insurance and securities law, was never a deliberate choice, but the mere result of its historical genesis. In most developed countries a wave of national prudential *banking legislation*, aiming at increased banking stability,[4] saw the light of day in the aftermath of the crisis of the 1930s.[5] International and European initiatives in the banking sector only emerged some fifty years later, resulting in the 1988 Basel Accord[6] and the first European banking directives.[7]

The oldest part of *securities regulation* on the other hand is concerned with mandatory disclosure via prospectus obligations.[8] With capital markets expanding and accessible to the public at large,[9] and a range of unregulated non-banking firms offering all kinds of unregulated "investment services", the need for a prudential regime for investment firms and conduct of business rules for the protection of investors[10] grew

4. "Prudential regulation" can be defined as preventive measures intended to ensure the soundness and safety of individual institutions (micro-perspective) and of the system as a whole (macro-perspective). See Dragomir, *European Prudential Banking Regulation and Supervision* (Routledge, 2010), p. 2. When used in this contribution, prudential regulation refers to micro-prudential regulation. This typically consists of authorization requirements, capital adequacy requirements for different categories of risk, risk management procedures and internal control mechanisms (Dragomir, p. 124 et seq).

5. For Germany, see e.g. Krieghoff, "Banking Regulation in a Federal System: Lessons from American and German banking history" (Doctoral thesis, 2013), 81, at <etheses.lse.ac.uk/758/1/Krieghoff_Banking_regulation_federal.pdf>; for France, see Bonneau, *Droit Bancaire* (L.G.D.J., 2013), p. 25; Piedelièvre and Putman, *Droit Bancaire* (Economica, 2011), p. 8; for Belgium, see Le Brun, *La Protection de l'Épargne Publique et la Commission Bancaire* (Bruylant, 1979), pp 54–56. The UK is a notable exception, not introducing any formal banking legislation until 1979. See Blair et al. (Eds.), *Banking and Financial Services Regulation* (Butterworths, 1998), p. 4; Proctor, *The Law and Practice of International Banking* (OUP, 2015), p. 4, para 1.04.

6. Basel Committee on Banking Supervision, "International convergence of capital measurement and capital standards", Bank for International Settlements, July 1988.

7. The First Banking Directive (77/780/EEC) harmonizing the conditions for the taking up and pursuit of the business of credit institutions dates back to 1977. In 1989 a range of new Directives were introduced, including Council Directive 89/647/EEC on a solvency ratio for credit institutions, O.J. 1989, L 386/1, implementing the Basel Accord.

8. Although mandatory information obligations were introduced in the 19th. century in several Member States, more generalized information and prospectus obligations were introduced in the aftermath of the crisis of the 1930s. See for the UK e.g. Hudson, *Securities Law* (Sweet & Maxwell, 2008), pp. 143–154; for Germany see Hopt, "Von aktien- und börsenrecht zum kapitalmarktrecht, teil 2: Die Deutsche entwicklung im internationalen vergleich", 141 ZHR (1977); for the Netherlands see Grundman-van de Krol, *Koersen door de Wet op het Financieel Toezicht* (Boom Juridische Uitgevers, 2012), pp. 4–5.

9. Moloney situates increasing household market participation in the early 1970s, the first major cycle of household market investment being most strongly associated with the period 1980–2000; see Moloney, *EU Securities and Financial Markets Regulation* (OUP, 2014), p. 775, with further references.

10. Conduct of business rules are a range of "principles of conduct which should govern the activities of financial services firms in protecting the interest of their customers and the integrity of the market". See IOSCO, "A Resolution on International Conduct of Business Principles", July 1990, nr. 18.

steadily.[11] Again, this resulted in sector-specific "securities regulation", first at national and later at international[12] and European level.[13]

Insurance law crystallized quite separately from the other two sectors of financial law, out of a combination of maritime law – it is widely believed that the contract of insurance was first used in underwriting marine risks – and commercial law usages.[14] Insurance contract law thus developed into a set of rules distinct from general contract law.[15] This trend towards specificity was later continued with respect to prudential rules. Whereas many European States introduced more or less extensive prudential and licensing requirements for (parts of) the insurance industry at the beginning of the 20th century (e.g. France, Germany and Italy), other States, such as the UK and the Netherlands, hardly had any such legislation. The first generation of European insurance law directives however made national legislatures introduce a generalized prudential and supervisory regime for the insurance sector.[16] Later still, aspects of insurance intermediation were harmonized at the EU level.[17] At the international level, the International Association of Insurance Supervisors (IAIS), promoting effective and globally consistent supervision of the insurance industry, was established in 1994.

11. For a short UK history, see Blair op. cit. *supra* note 5, pp. 11–13. The UK Gower Report of 1984 (Gower, "Review of investor protection, report, part I", Jan. 1984) not only laid the ground for the British 1986 Financial Services Act, but also inspired legislatures elsewhere in Europe as well as the European legislature when drafting the Council Directive 93/22/EEC on investment services in the securities field, O.J. 1993, L 141/27 (see note 13 *infra*).

12. IOSCO, "International equity offers: Summary report", Sep. 1989, stressing the need for "full and timely disclosure of all material information regarding the issue and trading of securities" (at 4); IOSCO, "Capital Standards for Securities Firms", Oct. 1989; IOSCO, "A resolution on international conduct of business principles".

13. The Investment Services Directive 93/22/EEC introduced a prudential regime for investment firms only in 1993. Directive 2003/70/EC amending Council Directive 91/414/EEC to include mecoprop, mecoprop-P and propiconazole as active substances, O.J. 2003, L 184/9 was only adopted in 2003. For an elaborate overview of the history of EU Securities Regulation, see Moloney, op. cit. *supra* note 9, pp. 11–24 and for a history of retail investor protection regulation in particular, see pp. 782–790.

14. See e.g. Vance, "The early history of insurance law", 8 *Columbia Law Review* (1908), 1–17.

15. See Cousy, "Insurance law between business law and insurance law" in Dirix and Leleu (Eds.), *The Belgian reports at the Congress of Washington of the International Academy of Comparative Law* (Bruylant, 2011), pp. 515–554.

16. Council Directive 73/239/EEC on the coordination of laws, regulations and administrative provisions relating to the taking-up and pursuit of the business of direct insurance other than life assurance, O.J. 1973, L 228/3 and Council Directive 79/267/EEC on the coordination of laws, regulations and administrative provisions relating to the taking up and pursuit of the business of direct life assurance, O.J. 1979, L 63/1.

17. Directive 2002/92/EC of the European Parliament and of the Council on insurance mediation (Insurance Mediation Directive or IMD), O.J. 2003, L 9/3.

Once a branch of the law has been distinguished, this mere fact reinforces its status as a separate discipline: scholars devote specific literature and look for branch-specific principles of the law; legislation aims at regulating sector-specific activities, products and institutions and introducing sector-specific regulatory restrictions and monopolies. Joanna Benjamin puts it as follows: "Historically, the business of each sector has been conducted by different institutions, staffed by different individuals, served by different support industries, reported in different journals, and studied in different university courses by people reading different books".[18]

This is why, at the end of the last century, both at a national and a European level, different sector-specific laws were applicable to the bank, securities and insurance sector, which in many Member States were supervised by separate sector-specific supervisors.

2.2. *Blurring of subsectors and regulatory arbitrage*

This sectoral approach to financial law however grew increasingly artificial, as the traditional sectors of the financial industry became less readily distinguishable.[19] Indeed, the end of the 20th century saw a convergence of business lines across sectors at institutional, as well as at sales and product level. More often than not, credit institutions, investment firms and insurance companies compete today on the same markets, vying for the same customers, with similar products and through identical distribution channels. Most "traditional" retail banks or banking groups provide banking and investment as well as insurance services. Investment products in some cases serve saving or even insurance purposes (e.g. credit default swaps). And certain (life) insurance contracts in essence serve little other than investment or saving purposes. A specific terminology has been created to capture this economic reality: "Allfinanz" strategies and products; "bancassurance", "assurfinance" and even "bancassurfinance".[20]

In a sectorally organized regulatory model, the qualification of a particular service or product as either a banking, investment or insurance product or service is of decisive importance to determine what rules apply. Depending on that qualification, markedly different rules may apply to services or products

18. Benjamin, *Financial Law* (OUP, 2007), p. 9.

19. Wymeersch, "The structure of financial supervision in Europe: About single, twin peaks and multiple financial supervisors", (2007) *European Business Organization Law Review*, 237, 270.

20. See e.g. Schüler, "The emerging role of single financial authorities: Germany", in Masciandaro (Ed.), *Handbook of Central Banking and Financial Authorities in Europe* (Edward Elgar, 2005), p. 292; Tison (Ed.), *Bancassurfinance (cahiers AEDBF/EVBRF-Belgium)* (Bruylant, 2000), p. 3.

that are highly similar from an economic point of view. This is not efficient for financial institutions which offer a range of different products or services, as they have to implement different processes depending on the formal sector in which the product or service is to be classified. It may moreover be confusing for retail customers if different standards are applicable to very similar situations. Unjustified differences between banking, securities and insurance legislation, which do not correspond to differences in the economic characteristics of the product or service, also create a more urgent problem: they become a fertile breeding ground for regulatory arbitrage.[21] The path of least resistance leads to an increased offering of the least regulated product or service or, worse, a repackaging of products in order to avoid the more burdensome legislation. This will usually not be in the best interest of the retail client.

3. Financial supervision in the EU and its Member States: The all-seeing eye(s)?

A first approach to reduce the risks stemming from sectoral legislation in an "all finance" environment has been to endow the same supervisor with the authority to control and regulate all financial services providers, products and services. In most Member States, financial supervisors indeed have important rule-making competences and therefore a direct impact on the applicable regulatory context. Cross-sectoral models of financial supervision should thus not only prevent the degree of supervisory bite being dependent on the financial sector, but also ensure convergent rulemaking and interpretation across business lines.[22] In Europe, such an evolution can be observed in several Member States. The sectoral tripartition of financial supervision at European Union level was however largely left unscathed, as is discussed in the next paragraphs.

21. See e.g. Kremers, Schoenmakers and Wierts, "Cross-sector supervision: Which model?" in Herring and Litan (Eds.), *Brookings-Wharton Papers on Financial Services: 2003* (Brookings Institution Press, 2003), p. 241. See also European Commission, "Call for Evidence: Need for a coherent approach to product transparency and distribution requirements for 'substitute' retail investment products?", 2007, at 3.

22. Lastra rightly points out that the terms "regulation" and "supervision" are often used interchangeably, although they are conceptually different. Supervision has to do with monitoring and enforcement, and regulation with rulemaking. See Lastra, *International Financial and Monetary Law* (OUP, 2015), pp. 112–113. Nevertheless, supervisors often act as rulemakers, which explains the frequent confusion of terminology.

3.1. *Evolution at Member State level*

3.1.1. *Two rounds of reform*

Historically many Member States had a different financial supervisor per financial sector (sectoral supervisory model).[23] In response to the problems associated with the blurring of sectors, several of those Member States chose to move towards a more integrated supervisory model, where a single authority was put in charge of supervising the three financial sectors (unitary or integrated supervisory model).[24] In the wake of the financial crisis[25] many Member States went through a second round of reform of their supervisory architecture. Supervisory tasks were typically redistributed to more than one supervisor, although this time not along the traditional sectoral lines, but on the basis of the nature of the rules under supervision (the so called "Twin Peaks" supervisory model).[26] In this model, one authority supervises conduct of business rules[27] whereas the other is in charge of prudential supervision.[28]

23. The Group of 30 distinguished between two sub-models of the sectoral supervisory model: the "institutional approach", meaning that a firm's legal status determines which regulator is tasked with overseeing its activity, and the "functional approach", meaning that supervisory oversight is determined by the business that is being transacted by the entity, without regard to its legal status. See Group of 30, "The structure of financial supervision: Approaches and challenges in a global marketplace", at 13–15, available at <www.group30.org /images/PDF/The%20Structure%20of%20Financial%20Supervision.pdf>.

24. De Luna Martinez and Rose, "International Survey of Integrated Financial Sector Supervision", World Bank Policy Research Working Paper 3096, July 2003; Herring and Carmassi, "The Structure of Cross-sector Financial Supervision", 17 *Financial Markets, Institutions & Instruments* (2008), 51–76; European Central Bank, "The role of central banks in prudential supervision", 22 March 2001, at 1, at <www.ecb.europa.eu/pub/pdf/other/ prudentialsupcbrole_en.pdf>. Lastra also mentions other efficiency reasons for the evolution towards a single supervisor, such as the fact that the number of people employed by a single authority is likely to be lower than the combined staff numbers of multiple authorities and the fact that financial institutions may find it expensive, confusing and time-consuming to answer similar questions to various supervisors; see Lastra, op. cit. *supra* note 22, p. 133.

25. To our knowledge, in the EU only the Netherlands already implemented the twin peaks model before the crisis (in 2002). See Busch et al., "Introduction" in Busch et al. (Eds.), *Onderneming en Financieel Toezicht, Recht en Onderneming* (Kluwer. 2010), pp. 2–3; Vlettert-Van Dort, *Wet Financieel Toezicht: Wonder of Waanzin?* (Kluwer, 2006), pp. 1–2.

26. For an in-depth discussion of the pros and cons of the different models, see Group of 30, op. cit. *supra* note 23. For an overview of supervisory structure in the different Member States, see European Central Bank, "Recent developments in supervisory structures in the EU Member States (2007–2010)", Oct. 2010. Since this document was published, supervisory structures in several Member States have been reformed again. Belgium, Germany and the UK are still mentioned in this study as adhering to the integrated supervisory model, but have since evolved towards a twin peaks model.

27. See definition in note 10, *supra*.

28. See definition in note 4, *supra*.

Each of the twin peaks supervisors exercises its competences with regard to all three financial sectors.[29]

3.1.2. *Evaluation*

Other than the idea of dealing with the problems associated with the blurring of sectors, the main argument which seems to have fueled the recent tendency towards adoption of a twin peaks supervisory model is that it should increase the level of expertise and specialization of the respective supervisors, whilst eliminating the threat that one supervisory task would dominate the other in terms of available resources and supervisory focus.[30] It has been argued that such a threat would be most likely to harm the quality of *prudential* supervision, under the assumption that it would be easier for a supervisor to raise its public profile through consumer protection matters (conduct of business supervision) than through prudential supervision, where problems are usually solved in a highly discrete fashion in order to prevent market disruptions.[31] The case of the EBA's nascent years, however, shows that if one institution is in charge of both prudential supervision and consumer protection, *either* of them might end up being neglected (*infra* section 3.2.2.1).

The increased emphasis since the financial crisis on macro-prudential supervision of the safety of the system as a whole, may also have contributed to the evolution towards a twin peaks model. There is a growing consensus that micro- and macro-prudential supervision are even more closely connected than micro-prudential and conduct of business supervision, and should therefore be performed by one and the same institution, the central bank.[32]

To our knowledge, it has however not been established whether any one model for financial supervision guarantees a higher level of market stability

29. About the different supervisory models, see e.g. Wymeersch, op. cit. *supra* note 19, 237–305.

30. For the UK, see House of Lords, Select Committee on Economic Affairs, *Banking Supervision and Regulation: Volume I: Report* (The Stationary Office, 2009), para 117: "There is a widely held perception that, in recent years, the FSA has emphasized conduct-of-business supervision at the expense of prudential supervision". Lord Turner acknowledged this: "It is broadly speaking true to say that in retrospect we focused too much on the conduct of business and not enough on prudential" and at para 121: "Regulatory bodies are subject to conflicting political pressures. There is a danger that, when a single institution has responsibility for conduct-of-business and prudential supervision, one will be emphasized at the expense of the latter. Institutional arrangements in the future must be designed so as to minimize this danger"; for the Netherlands see Grundmann-van de Krol, "Ondernemingsrecht, geschiktheid, betrouwbaarheid en de beoordeling daarvan: Het 'twin peaks'-toezichtmodel wankelt", (2011) Ondernemingsrecht, 68.

31. Kremers, Schoenmakers and Wierts, op. cit. *supra* note 21; House of Lords, Select Committee on Economic Affairs, op. cit. *supra* note 30, paras. 117 and 121.

32. For this and other arguments in favour of attributing micro-prudential supervision to the Central Bank, see European Central Bank, *supra* note 24.

and investor protection.[33] It has, on the contrary, been argued that the model a country adopts is often rooted in historical and political considerations.[34] Reforms are usually provoked by a highly mediatized and politicized societal shock, such as the financial crisis, and may be mainly inspired by their palatable effect to the public at large, even if their merit in improving market stability or investor protection is uncertain.[35]

Insofar as cost-efficiency can be considered to be a valid criterion by which to judge a supervisory structure, the twin peaks model is usually not considered the most cost-efficient manner to structure financial supervision.[36] Inefficiencies may result from a suboptimal division of powers, still allowing some prudential supervisory powers to the conduct of business supervisor or vice versa. This obviously creates inefficiencies and duplication of competences.[37] Even if the division is well-established, both supervisors will need highly similar information, which can result in a duplication of notification requirements for financial institutions, which have to report the same or similar information twice, often in a different format.

More fundamental is that, even if the underlying idea of the model is to separate two different supervisory functions, in practice it appears nearly impossible to avoid "gaps and overlaps".[38] The foundation of the twin peaks model is that each of the supervisors has a number of exclusive competences.

33. See Lastra, op. cit. *supra* note 22, p. 133; High level committee for a new financial architecture, "Final Report" ("de Larosière Report"), June 2009, 44.

34. Lastra, op. cit. *supra* note 22, p. 133.

35. Ibid., pp. 133–134. See also e.g. Carmichael, "Australia's approach to regulatory reform", in Carmichael et al., *Aligning Financial Supervisory Structures With Country Needs* (World Bank Institute, 2004), pp. 95–96: "Restructuring in response to regulatory failure is probably the weakest ground for reform… New structures do not guarantee better regulation. More appropriate structures may help but, fundamentally, better regulation comes from stronger laws, better-trained staff and better enforcement". Belgium even introduced the twin peaks model against the recommendations of the "Special Commission for conducting research on the Financial and Banking Crisis". This committee had explicitly advised against the introduction of a functionally divided supervisory system, but was proponent of a reinforcement of the existing supervisory structures. See Incalza, "Toezicht op de financiële sector volgens het bipolaire twin peaks-model: Anders en beter?", 3 *Tijdschrift voor Rechtspersoon en Vennootschap* (2012), 181.

36. Taylor, "The road from 'twin peaks' and the way back", 1 *Connecticut Insurance Law Journal* (2009), 89.

37. Although prudential and anti-money laundering supervision is in Belgium e.g. in principle the task of the National Central Bank (since the introduction of the Single Supervisory Mechanism prudential supervision to a large extent the ECB), the conduct of business supervisor, FSMA, is competent for licensing and prudential, as well as anti-money laundering supervision of investment firms. This means an inefficient duplication of prudential and anti-money laundering competences at both authorities.

38. For the UK, see Willmott and James, "Supervision under the twin peaks regime", at <www.blplaw.com/expert-legal-insights/articles/supervision-under-the-twin-peaks-regime/>; For Belgium see Incalza, op. cit. *supra* note 35, referring to the preparatory documents.

Many legal requirements, however, unite both prudential and conduct of business aspects and are very difficult to attribute exclusively to one of the twin peaks supervisors without creating some kind of supervisory deficit.[39] Such problems could and should be remedied by a high degree of information exchange and cooperation.[40] Even though most Member States with twin peaks supervisors do have formal cooperation structures, there is an obvious learning process.[41]

From the perspective of ensuring a level playing field between the different sectors of the financial industry, the integrated and twin peaks supervisory models seem equally adequate. The recent tendency to choose the twin peaks model over the integrated model should therefore be attributed to other considerations, the validity of which has not yet been tested.

39. Report by the Comptroller and Auditor General, "The Financial Conduct Authority and the Prudential Regulation Authority – Regulating Financial Services", 24 March 2014, HC 1072 2013–14, at 8.6 and at 14.1.8: "Both regulators undertake broadly similar regulatory functions, in pursuit of different objectives . . . Some firms are subject to 'dual regulation', with their conduct regulated by the FCA and prudential matters regulated by the PRA. This requires coordination between the two regulators to ensure not only that there is no duplication, but also that there are no gaps in regulatory cover that firms are exploiting". Kremers and Schoenmaker refer to a high-profile Dutch case, that of former Finance Minister Gerrit Zalm as DSB's CFO, where the Dutch National Bank and the Dutch Financial Markets Authority both had a say on the fit and proper test but took opposing views. The DNB overruled AFM's negative conclusion. Such public dispute between supervisors was perceived as damaging to the reputation of both supervisors. See Kremers and Schoenmaker, "Twin Peaks: Experiences in the Netherlands", LSE Financial Markets Group Paper Series, Special Paper 196, Dec. 2010, 7. Compare to the Report by the Comptroller and Auditor General, at 14.1.10–1.11: discussing a similar problem where both UK supervisors make regulatory decisions on the same matter. See also Ferran, "European Banking Union: Imperfect, but it may work", University of Cambridge Faculty of Law Research Paper No. 30/201417, 17 April 2014, at 8. Available at <ssrn.com/abstract=2426247> or <dx.doi.org/10.2139/ssrn.2426247>.

40. It has been pointed out that sufficient cooperation is a challenge in any supervisory approach with multiple institutions. See Group of 30, op. cit. *supra* note 23: "Maintaining adequate levels of cooperation and information sharing across governmental agencies appears to be both equally important and challenging regardless of the supervisory approach adopted in the jurisdiction".

41. See e.g. Report by the Comptroller and Auditor General, cited *supra* note 39, at 8.11 and 33.3.13: "In addition to the formal structures in place to facilitate coordination between the FCA and PRA …, good day-to-day working relationships and interactions between staff at both regulators are important, in particular to ensure that the burden placed on firms when interacting with the regulators is minimized. Working-level communication between the regulators is regular and a good working relationship seems to exist between supervisors, although there are concerns that this legacy of when they were working more closely at the FSA could deteriorate over time. Industry views tend to highlight that coordination between the regulators can be poor where the firm is too small to warrant a named supervisor at the FCA".

3.2. *Evolution at the EU level*

3.2.1. *Overview*

The financial crisis also led to a significant redesign of European supervisory structures, with the introduction of the European System of Financial Supervisors (ESFS) as of 1 January 2011 and the introduction of a Single Supervisory Mechanism as part of the Banking Union as of 1 November 2014. This evolution has been described in detail elsewhere.[42] It is briefly summarized below in order to evaluate it from the perspective of the extent to which it remedies the problems associated with the blurring of sectors.

3.2.1.1. *European System of Financial Supervision (ESFS)*

As part of the European System of Financial Supervision, three European Supervisory Authorities (ESAs) have been established, one for each of the financial sectors: the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA).[43] The European Supervisory Authorities are composed of representatives of the national supervisors for those three sectors, who cooperate within the ESAs to establish common interpretation and implementation standards. In the European System of Financial Supervision the bulk of financial supervision, however, still remains at Member State level, notwithstanding some important exceptions.[44]

42. See e.g. Ferran, "Understanding the new institutional architecture of EU financial market supervision", in Ferrarini, Hopt and Wymeersch (Ed.), *Financial Regulation and Supervision: A Post-Crisis Analysis* (OUP, 2012), pp. 111–158; Wymeersch, "The European financial supervisory authorities or ESA's", in Ferrarini et al., id., pp. 232–317; Ferran and Babis, "The European single supervisory mechanism" 13 *Journal of Corporate Law Studies* (2013), 255–285; Moloney, "European Banking Union: Assessing its risks and resilience", 51 CML Rev. (2014), 1609–1670; Wolfers and Voland, "Level the playing field: The new supervision of credit institutions by the European Central Bank", 51 CML Rev. (2014), 1463–1496.

43. They succeeded, respectively, the Committee of European Banking Supervisors, the Committee of European Insurance and Occupational Pensions Supervisors and the Committee of European Securities Regulators. In addition, the European Systemic Risk Board (ESRB) was established with a mandate to oversee risk in the financial system as a whole; Regulation (EU) 1092/2010 of the European Parliament and of the Council of 24 Nov. 2010 on European Union macro-prudential oversight of the financial system and establishing a European Systemic Risk Board (the "ESRB Regulation"), O.J. 2010, L 331/1 and Council Regulation (EU) 1096/2010 of 17 Nov. 2010 conferring specific tasks upon the European Central Bank concerning the functioning of the European Systemic Risk Board, O.J. 2010, L 331/162.

44. The most notable exception to the principle of Member State supervision are rating agencies (Art. 14 Credit Rating Agency Regulation 1060/2009), which are directly supervised by ESMA. The ESAs further have the power to take individual decisions addressed to financial market participants in three particular cases (Art. 16 (6); 17 and 19 of ESA Regulations

3.2.1.2. *Banking Union – Single Supervisory Mechanism*

The 2014 introduction of a Banking Union brought a sea change to this longstanding characteristic of European financial supervision. The Banking Union introduced a supervisory system known as the "Single Supervisory Mechanism" (SSM)[45] in order to strengthen prudential supervision of credit institutions in the Eurozone.[46] The essential tasks of *prudential* supervision of the *banking* sector in the Eurozone are now for the first time performed at the EU level, by the European Central Bank.

There are, however, many exceptions. National prudential supervisors should in the first place assist the ECB in the preparation and implementation of any acts relating to the exercise of its supervisory tasks, including the ongoing day-to-day assessment of credit institutions' situation and related on-site verifications.[47] With regard to "less significant credit institutions",[48] the tasks and autonomy of national supervisors stretch much further still. After such a "less significant credit institution" has been authorized by the ECB, most supervisory tasks remain with the national prudential supervisor,[49] although the ECB may at any time decide to take over and directly exercise all the relevant powers for one or more of these "less significant" credit institutions.[50]

National supervisors obviously also remain fully competent for the supervisory tasks which are outside the scope of the SSM, such as non-prudential tasks (conduct of business supervision, the fight against money laundering,…)[51] and supervision of national credit institutions which are not covered by the definition of credit institution under EU law.[52]

1093/2010; 1094/2010 and 1095/2010. See in more detail Di Noia and Furlò, "The new structure of financial supervision in Europe: What's next" in Ferrarini et al., op. cit. *supra* note 42, pp. 180–181.

45. Council Regulation (EU) 1024/2013 conferring specific tasks on the European Central Bank concerning policies relating to the prudential supervision of credit institutions (SSM Regulation), O.J. 2013 L 287/63; Regulation (EU) 1022/2013 of the European Parliament and of the Council amending Regulation (EU) 1093/2010 establishing a European Supervisory Authority (European Banking Authority) as regards the conferral of specific tasks on the European Central Bank pursuant to Council Regulation (EU) 1024/2013, O.J. 2013, L 287/5.

46. The ECB may also become the prudential supervisor in non-euro EU Member States that voluntarily choose to join the SSM.

47. Recital 37 and Art. 6 (3) SSM Regulation.

48. Art. 6 (4) and recitals 38–39 SSM Regulation. The ECB publishes and regularly updates lists of significant and less significant banks at <www.bankingsupervision.europa.eu/banking/list/who/html/index.en.html>.

49. Art. 6 (6) read with (4) SSM Regulation.

50. Art. 6 (5) (b) SSM Regulation.

51. Recitals 28–29 SSM Regulation.

52. Wolfers and Voland, "Level the playing field: The new supervision of credit institutions by the European Central Bank", 51 CML Rev. (2014), 1469.

3.2.2. *Evaluation*

3.2.2.1. *Sectoral EU supervisory structure…*

Contrary to the evolution in most Member States, the traditional sectoral approach to supervision continues to prevail at the European level, even though the 2009 de Larosière report highlighted the merits of a "twin peaks" supervisory structure.[53] The idea to set up all three ESAs in one Member State city, which might well have contributed a great deal to a more integrated EU supervisory structure, received broad support in the European Parliament, but proved politically unfeasible: the ESAs have been established in London, Frankfurt and Paris respectively.[54] Instead, a Joint Committee was put in place in order to deal with the increasing number of cross-sectoral issues.[55]

The European Commission was given the task of subjecting the three ESAs to a general review every three years, amongst other things to examine whether it is appropriate to continue separate supervision of banking, insurance and occupational pensions, and securities and financial markets.[56] In its 2014 report, the Commission pointed out that the role, visibility and transparency of the Joint Committee could be strengthened.[57] In a somewhat Delphic statement, the Commission added that calls for structural changes to the architecture of the European Supervisory Authorities, such as merging the authorities into a single seat or introducing a twin peaks approach, should be "carefully assessed in light of the establishment of Banking Union and the ESRB".[58]

53. De Larosière Report, *supra* note 33, at 58, para 216: "There may be merit, over time, in evolving towards a system which would rely on only two Authorities: The first would be responsible for banking and insurance issues, as well as any other issue which is relevant for financial stability (e.g. systemically important hedge funds, systemically important financial infrastructures). The second Authority would be responsible for conduct of business and market issues, across the three main financial sectors. Combining banking and insurance supervisory issues in the same Authority could result in more effective supervision of financial conglomerates and contribute to a simplification of the current extremely complex institutional landscape".

54. See Ferran, op. cit. *supra* note 42, para 5.42.

55. Arts. 54–57 of EBA Regulation 1093/2010; EIOPA Regulation 1094/2010 and ESMA Regulation 1095/2010.

56. Art. 81 of ESA Regulations 1093/2010; 1094/2010 and 1095/2010.

57. European Commission, "Report to the European Parliament and the Council on the operation of the European Supervisory Authorities (ESAs) and the European System of Financial Supervision (ESFS)", COM(2014)509 final, 8–10: "Furthermore, to ensure a framework consistent across sectors and appropriate coordination of the ESAs' activities, more use could be made of the Joint Committee (JC). This could be achieved for instance, by the exchange of best practices between the authorities which would allow for better definition and clarification of their relevant competences in line with the legal basis".

58. Ibid., at 11. For the ESRB, *supra* note 12.

The Banking Union's Single Supervisory Mechanism (SSM) does not as such challenge the traditional sectoral approach. Only within one subsector, banking, prudential supervision is now to a large extent taken care of at the EU level. Within the banking sector the SSM has introduced a functional (twin peaks) division of supervisory tasks: prudential banking supervision is now mainly performed by the ECB; conduct of business supervision of the banking sector remains with national supervisors (and this irrespective of whether Member States apply a sectoral, integrated or twin peaks supervisory model).

The result is a rather complicated supervisory structure in Europe. Financial supervision in the *securities* and *insurance* sector is still mainly performed at the national level, with national supervision structured either along the sectoral, integrated or, increasingly, the twin peaks supervisory model. These national supervisors cooperate within and receive guidance from the sectorally competent ESAs, ESMA and EIOPA. Supervision of the *banking* sector in the eurozone is however functionally divided between the ECB – which is the prudential banking supervisor for the eurozone (with assistance of national authorities) – and the eurozone Member State supervisors which remain competent for, among other things, conduct of business supervision. Prudential banking supervision in non-eurozone Member States remains the competence of the national supervisors. The European Supervisory Authority for the banking sector, the EBA, meanwhile remains competent for guidance with respect to the interpretation of European banking legislation and as a forum for cooperation between all EU prudential supervisors.

In view of the fact that in the securities sector ESMA already had some direct supervision powers,[59] the attribution of direct supervisory powers in the banking sector to the ECB instead of the EBA (although defendable in many respects) stresses and enhances the asymmetry in powers between the different ESAs.

3.2.2.2. *…versus Member State evolution towards the twin peaks model*

Whereas supervision at Member State level is increasingly organized along the twin peaks model, the supervisory structure at European Union level continues to be organized along sectoral lines. Nevertheless, the need for cooperation between national supervisors at the EU level is ever increasing.[60] The differing models at EU and Member States level may however render such cooperation inefficient, since national supervisory authorities can be

59. *Supra* note 44.
60. See e.g. Ferrarini and Chiodini, "Nationally fragmented supervision over multinational banks as a source of global systemic risk: A critical analysis of recent EU reforms" in Ferrarini et al., op. cit. *supra* note 42, pp. 193–231.

represented by one representative only at each of the three ESAs. Twin peaks national supervisors will therefore have to decide amongst themselves *which* national supervisory authority (the prudential or the conduct of business authority) will send a representative to EBA, ESMA and EIOPA. The result may be that not all national representatives will have sufficient expertise on both prudential and conduct of business matters.[61]

The European Court of Auditors pointed out in a 2014 special report that EBA's mandate on consumer protection matters in the market for financial products and services in the EU had not been given high priority and remained under-resourced.[62] One of the reasons for this preponderant focus by EBA on prudential matters and of the preponderant focus of ESMA on conduct of business matters[63] may well be that in Member States with twin peaks supervisors, the prudential supervisor will typically send a delegate to EBA,[64] whereas the conduct of business supervisor will send a delegate to ESMA.

For practical and political reasons, any move towards a cross-sectoral supervisory model at the EU level in the short or medium term seems highly unlikely (*supra* section 3.2.2.1.). The different structures of financial supervision at EU and Member State level however seem to imperil the efficient cooperation between national supervisors and the European Supervisory Authorities in an environment where the supervisory structure at

61. When the Board of Supervisors of an ESA discusses an item that does not fall within the mandate of the voting national supervisory authority, the latter may bring a representative from the relevant national authority, who shall be non-voting. However, the European Court of Auditors found that in 2011 and 2012, no representatives of national consumer protection authorities were present at the Board of Supervisors' meetings of EBA when consumer protection issues were discussed. See Special Report of the European Court of Auditors, "European banking supervision taking shape: EBA and its changing context", No. 5/2014, 2 July 2014, at 33.

62. Ibid., at 32.

63. Although a preponderating focus of ESMA has not (yet) established as problematic in an official report, the ESMA guidelines clearly show such focus.

64. See in this regard the following observation in the Report from the Commission to the European Parliament and the Council, COM(2014)509 final, at 8: "As a matter of fact several national authorities represented in the respective BoS do not hold consumer protection mandates at national level and thus lack the necessary expertise and tend to prioritize other issues of more direct concern to them. To remedy this fact the ESAs could introduce a mechanism to ensure close cooperation and the involvement of the relevant national authorities in order to bring in the expertise and ensure a comprehensive approach to consumer protection at ESAs level"; and at 9: "As a first step to address stakeholders' concerns, the ESAs should consider to give a higher profile to consumer/investor protection related issues (incl. increased visibility) and making full use of available powers. Similarly broader and more structured use could be made of the Joint Committee. The ESAs should also ensure, to the extent possible, the co-operation with and the involvement of national authorities competent in the field of consumer protection where these are distinct from those represented at the level of the Board of Supervisors".

the EU level itself seems excessively complicated. Increased cooperation between the different ESAs in the Joint Committee is only part of the solution. In addition, having separate meetings to deal with prudential or conduct of business issues within each of the three ESAs could allow national twin peaks supervisors to send the most competent delegate to each meeting and thus help in overcoming the problem that one of the supervisory tasks of EBA, ESMA and EIOPA would dominate the other.

These are however only suggestions to remedy shortcomings to the current system in the short run. More far-reaching solutions are discussed in section 5 below.

4. Investor protection regulation in the EU

4.1. *Background*

The integration of financial supervision across the traditional sectoral lines is only part of the answer to the challenge posed by the blurring of boundaries between financial sectors. Even if financial supervisors often do have some regulatory powers, they must respect and cannot change the scope of applicable legislation. If the legislative framework continues to be organized along traditional sectoral lines, even a single supervisor for the three sectors of the financial industry may still have to apply different sets of rules to similar products and services.

With the notable exception of the Netherlands, which has introduced a generalized functional approach to financial law as of 1 January 2007,[65] Member States have not attempted to overhaul their national financial legislation in a cross-sectoral manner. Many Member States however did take more or less limited cross-sectoral measures, especially in the field of investor protection,[66] making some kind of European intervention almost unavoidable.[67]

65. Act of 28 Sept. 2006 on financial supervision. See for a thorough overview Grundmann-van de Krol, op. cit. *supra* note 8. The author explains at p. 14 that this legislative overhaul represented a second step in the evolution needed to adapt the Dutch financial law to the functional structure of financial supervision (the twin peaks model was introduced in the Netherlands in 2002).

66. See e.g. European Commission, "Feedback statement on contributions to the call for evidence on 'substitute' retail investment products", March 2008, 33–34. Since this document was published, further initiatives have obviously been taken.

67. Ibid., at 35: "All consumers and many public authorities foresaw a role for the EU but there was a wide divergence of views among industry responses, where just over half saw a case for EU involvement in some form. However, such support was strongly qualified by the need to

As early as 1999, the Commission stressed the need for a "holistic", cross-sectoral approach to financial legislation in the EU.[68] As it turned out, that policy statement did not translate into a new approach to legislation in the following years. Concrete action in this area was not taken until 2007, when the Council invited the Commission "to review the consistency of EU legislation regarding the different types of retail investment products (such as unit-linked life insurance, investment funds, certain structured notes and certificates), so as to ensure a coherent approach to investor protection and to avoid any miss-selling possibilities".[69] It had indeed been clear for many years that the retail market for investment products was highly vulnerable to regulatory arbitrage.[70]

The Commission responded to the Council's invitation by publishing a call for evidence on the need for a coherent approach to product transparency and distribution requirements for (what it at that time labelled as) "substitute" retail investment products.[71] Although the answers to this call did not exactly unequivocally point in the direction of European coordination,[72] the Commission, capitalizing on the impetus for improved retail investor protection in the wake of the crisis, decided that it would take steps to "bring the European legislative framework for mandatory disclosures and sales practices for packaged retail investment products into line with market reality".[73] The project thus changed names from "'substitute' retail investment products" to "packaged retail investment products" (PRIPs).

ensure that intervention is only considered if a clear market failure is identified and must be accompanies by strict and rigorous cost-benefit analysis".

68. Communication of the Commission, "Financial Services: Implementing the framework for financial markets: Action Plan", COM(1999)232, 16: "A piecemeal and reactive approach to proposing and designing actions is inadequate in a situation where financial conglomerates are common-place and the boundaries between financial services are being steadily blurred. A holistic, cross-sectoral view is required in setting regulatory priorities, in avoiding tensions between policy objectives in different segments of the financial markets and in expanding the range of policy solutions".

69. Council of the European Union, "2798th. Council Meeting Economic and Financial Affairs", Press Release 9171/07, 8 May 2007.

70. For concrete examples, see Moloney, op. cit. *supra* note 9, p. 780; European Commission, "Open Hearing on Retail Investment Products", 15 July 2008, at 11, indicating that in France, sales of unit-linked life insurance have increased following the implementation of MiFID; see also 17, where several examples of regulatory arbitrage in the Netherlands are given, and 18, where Eddy Wymeersch, chairman of CESR at the time, argued that regulatory arbitrage has been seen on a massive scale through the growth of the certificate market.

71. European Commission, call for evidence, cited *supra* note 21.

72. European Commission, feedback statement, cited *supra* note 66, 35–36.

73. Communication of the Commission to the European Parliament and the Council, "Packaged Retail Investment Products", COM(2009)204 final, at 2. Those steps included an impact assessment (Europe Economics, "Study on the costs and benefits of potential changes to distribution rules for insurance investment products and other non-MiFID Packaged Retail

The PRIPs-project intended to tackle the divergence in financial regulation with regard to highly similar – but legally distinct – investment products available to retail investors. To put it in the European Commission's words, "(t)he level of protection afforded to the retail investor should not vary according to the legal form of these products".[74] The Commission therefore set out to define "a more horizontal approach to regulation" with respect to retail investor protection.[75] This approach was claimed to rest on two pillars. First, investors should be properly *informed* about the product they are considering buying before entering into any transaction. Product information is however only one of the factors relevant for investor decision making. Second, the *sales process* itself and the role of advisors or sellers are considered predominant in determining or influencing investor choices in many practical sales environments.[76] Although not envisaged in the PRIPs-project, product banning can be considered a third pillar of retail investor protection that should be examined in respect of the trend towards a more horizontal approach to regulation. Prohibiting the sale of certain very complex or risky products to retail investors is indeed the ultimate step to protect them.

The more horizontal EU approach to financial regulation has not been achieved by means of a single legislative document as one might have expected. Next to a "horizontal" PRIIPs[77] Regulation[78] with respect to product information, an attempt to level the playing field with respect to sales rules was made in two pre-existing sector-specific EU directives: the Markets in Financial Instruments Directive (MiFID)[79] and the Insurance Mediation

Investment Products", 29 Sep. 2010) and another consultation, this time on more concrete legislative steps for the PRIPs initiative (Consultation by Commission Services on legislative steps for the Packaged Retail Investment Products Initiative, 26 Nov. 2010).

74. Commission Communication, cited previous note, at 1. See also the Explanatory Memorandum to the Proposal for a Regulation of the European Parliament and of the Council on key information documents for investment products, COM(2012)352, at 2: "Existing disclosures vary according to the legal form a product takes, rather than its economic nature or the risks it raises for retail investors. The comparability, comprehensibility and presentation of information vary, so the average investor can struggle to make necessary comparisons between products".

75. Commission Consultation, cited *supra* note 73, at 2.

76. Explanatory Memorandum cited *supra* note 74, at 5.

77. See section 4.2.1 for an explanation of the additional "I" in "PRIIPs Regulation".

78. Regulation (EU) 1286/2014 of the European Parliament and the Council on key information documents for packaged retail and insurance-based investment products (PRIIPs), O.J. 2014, L 352/1.

79. Directive 2004/39/EC ("MiFID I") was recently replaced by Directive 2014/65/EU of the European Parliament and the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU ("MiFID II"), O.J. 2014, L 173/349.

Directive (IMD).[80] Likewise competences for product banning have been introduced in the PRIIPs Regulation on the one hand and in the Markets in Financial Instruments Regulation ("MiFIR") on the other.[81]

4.2. *Information*

4.2.1. *Overview*

With the PRIIPs Regulation the European legislature wanted to solve the following frequently described problems: (i) investors do not read, understand or digest extensive and / or technical information and (ii) they hardly compare the products and services of different financial institutions.[82] The PRIIPs Regulation therefore requires product manufacturers to produce, as from 31 December 2016, a "Key Information Document" or "KID" for a range of investment products (Art. 8 PRIIPs Regulation).

The KID should use clear, succinct and understandable language, which is easily accessible for the retail investor. It should be short, with a maximum length of 3 sides of A4-sized paper.[83] In order to meet the information needs of

80. Directive 2002/92/EC has been amended by MiFID II and will soon be replaced by the Insurance Distribution Directive (IDD). See the Draft Insurance Distribution Directive; Proposal for a Directive of the European Parliament and of the Council on insurance mediation (recast) – Confirmation of the final compromise text with a view to agreement, 16 July 2015, <data.consilium.europa.eu/doc/document/ST-10747-2015-INIT/en/pdf>.

81. Art. 16 PRIIPs Regulation; Arts. 40–41 of Markets in Financial Instruments Regulation (MiFIR) (EU), O.J. 2014, L 173/84.

82. Information overload was already a concern of the industry during the first call for evidence (see Commission, Feedback Statement, cited *supra* note 66, 20). The problem was confirmed in the Commission's Consumer Markets Scoreboard SEC(2010)1257, "Making Markets Work for Consumers" (4th ed., October 2010). This report moreover shows that the market for "investments, pensions and securities" performs worst out of the 50 sectors examined, *inter alia* with respect to comparability of products and services (p. 15). An earlier Consumer Markets Scoreboard concluded: "A recent survey found that … information which is presented in too many different ways when comparing between different offerings are … important barriers to cross-border shopping of financial services quoted by European consumers" and "As evidenced by a series of surveys, a well-drafted set of standardized information facilitates clearly the comparability of competing offers, and help ensure that consumers understand and can use information e.g. for switching providers. … In a Eurobarometer survey, 79% of European citizens thought that it would be useful if all financial services providers used a standardised information sheet. …" (SEC(2009)1251, "Commission Staff Working Document on the Follow up in Retail Financial Services to the Consumer Markets Scoreboard" (22 Sept. 2009) 6 and 9). The argument was repeated in the explanatory Memorandum to the Proposal for a PRIPs Regulation, at 8-9 and in recital 15 to the PRIIPs Regulation.

83. Recital 14 and Art. 6 (4) PRIIPs Regulation. It should be noted that the PRIIPs KID is allowed one A4 side more than the UCITS KID; see Art. 6 of Commission Regulation (EU) 583/2010 of 1 July 2010 implementing Directive 2009/65/EC of the European Parliament and

the retail investor and to allow for easy comparison of various PRIIPs,[84] the document should be drawn up in a standardized format, ensuring that the items are in the same order and under the same headings in each document.[85]

Four product families were targeted by the original PRIPs project: investment (or mutual) funds; investments packaged as life insurance policies; retail structured securities; and structured term deposits.[86] The very idea of the project was however to define a scope not on the basis of the *legal* form of a product, but rather on the basis of its economic purpose for the investor. That is why the final PRIIPs Regulation has opted for a broad definition of "packaged retail investment product" or "PRIP", rather than enumerating a number of product families. Article 4(1) of the PRIIPs Regulation defines a PRIP as "an investment…where, regardless of the legal form of the investment, the amount repayable to the retail investor is subject to fluctuations because of exposure to reference values or to the performance of one or more assets which are not directly purchased by the investor".

Although insurance-based investment products had been included in the scope of the PRIPs project from the outset, the European Parliament deemed it necessary when the project reached the end of its arduous legislative road, to add an additional "I" so that the acronym became "PRIIPs" and had come to designate "packaged retail and insurance-based investment products". Next to the PRIP-definition, the following definition of "insurance-based investment product" was added in Article 4(2) PRIIPs Regulation: "an insurance product which offers a maturity or surrender value and where that maturity or surrender value is wholly or partially exposed, directly or indirectly, to market fluctuations".[87]

of the Council as regards key investor information and conditions to be met when providing key investor information or the prospectus in a durable medium other than paper or by means of a website, O.J. 2010, L 176/1.

84. Recital 17 PRIIPs Regulation.

85. Recital 17 and Art. 8 PRIIPs Regulation.

86. CESR, CEBS and CEIOPS, "Report of the 3L3 Task Force on Packaged Retail Investment Products (PRIPs)", 6 Oct. 2010, No. 3.

87. Seven types of insurance contracts, deposits, securities and pension products are nevertheless excluded (Art. 2(2) PRIIPs Regulation):

The Regulation shall not apply to the following products:

(a) non-life insurance products as listed in Annex I to Directive 2009/138/EC;
(b) life insurance contracts where the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;
(c) deposits other than structured deposits as defined in point (43) of Art. 4(1) of Directive 2014/65/EU;
(d) securities as referred to in points (b) to (g), (i) and (j) of Art. 1(2) of Directive 2003/71/EC;

4.2.2. *Evaluation*

The basic principles behind the PRIIPs Regulation can only be supported. Nevertheless the concrete elaboration of those principles merits important comments.

First, the European legislature seems to have difficulties in abandoning an approach based on legal form. The "PRIP" definition intended to refer to economic substance instead of legal form. The introduction of a separate definition of "insurance-based investment product", defined with reference to its sectoral origin as "an insurance product...", has however undermined this intention. Without this additional definition, the use of the word "investment" in the PRIP definition could only be interpreted as an investment in the economic sense, including insurance-based investment products. The addition of a separate definition of "insurance-based investment product" however suggests that such an "insurance product" cannot be considered a "packaged retail investment product", which in turn casts doubt over the question how the term "investment" should be interpreted in the definition of "PRIP".

Second, although the PRIIPs Regulation has been explicitly presented as an answer to the negative effects of regulatory arbitrage for financial consumers, it only covers "packaged" products – thus creating anything but a level playing field between PRIIPs and various other financial products. Two examples are telling in this regard.

In the banking sector, only so-called "structured deposits"[88] are within the scope of the PRIIPs Regulation; "simple" deposits with fixed or floating rates continue to escape from any harmonized customer protection. Although those simple deposits may in principle indeed be more easy to understand for a retail public, their terms and conditions often include complicated interest

(e) pension products which, under national law, are recognized as having the primary purpose of providing the investor with an income in retirement and which entitle the investor to certain benefits;
(f) officially recognized occupational pension schemes within the scope of Directive 2003/41/EC of the European Parliament and of the Council (1) or Directive 2009/138/EC;
(g) individual pension products for which a financial contribution from the employer is required by national law and where the employer or the employee has no choice as to the pension product or provider.

88. According to Commission Communication COM(2009)204 final, at 4, "Structured term deposits offer a combination of a term deposit with an embedded option or an interest rate structure. They are designed to achieve a specific payoff profile, which they achieve through transactions in derivatives such as interest rate and currency options".

calculations[89] and hidden costs. Such simple deposits are therefore not always transparent and can be hard to assess and compare. Consumers may, moreover, actually have an interest in comparing *structured* deposits with *simple* deposits. Inclusion of simple deposits within the scope of the PRIIPs Regulation would not only have increased transparency with regard to these products but would also have facilitated such very relevant comparison. It should further be noted that several Member States already impose information requirements for (simple as well as structured) deposits today at national level. As simple deposits are outside the scope of the PRIIPs Regulation, Member States are not obliged to align information requirements for simple deposits with the PRIIPs Key Information Document. Having different regimes in place for products which may well be substitutes from an investor's perspective, not only complicates comparability, it also adds unnecessary costs for financial institutions. They may have to implement two different information models: one for PRIIPs and another for non-PRIIPs, which are subject to a national regime. If financial institutions engage in cross-border activities they may even need to produce different information sheets in different Member States for those non-harmonized products.

A second example of the (overly) limited scope of application of the PRIIPs Regulation, is that of transferable securities. Structured securities[90] are subject to the PRIIPs Regulation whereas no KID needs to be available for "simple" securities. Should the investor wish to compare a structured security (e.g. a convertible bond) with a simple security (e.g. a simple bond), there is no KID available to facilitate such comparison, merely because non-PRIIPs are not considered "packaged" or "manufactured". Economically they may however well be regarded as substitutes.[91] It can be argued that, from a retail investor's point of view, the need for useful product comparison is not limited

89. On top of a fixed interest rates, there are often loyalty or other premiums, or use is made of temporary higher rates, making it hard to compare the conditions of different simple saving deposits.

90. According to the Commission Communication COM(2009)204 final, at 4: "Structured securities are derived from or based on a single security, a basket of secure ties, an index, a commodity, a debt issue and/or a foreign currency. Normally in a structured security an investment bank promises to make, at a pre-determined time, a payout based on a pre-determined formula. The majority of structured securities offer full protection of the principal invested at the end of their term, whereas others offer leveraged returns but limited or no protection of the principal. They may be sold to investors as, inter alia, certificates, structured notes (bonds) or warrants".

91. It should be noted that in the context of the Commission's idea to create a "Capital Markets Union" the Prospectus Directive is under review. One of the issues examined is exactly whether there is a need to reassess the summary prospectus, amongst other things in view of the PRIIPs KID. See European Commission, "Green paper: Building a Capital Markets Union", COM(2015)63 final, at 10; European Commission, "Consultation document: Review of the prospectus directive", 18 Feb. 2015, at 5 and 16–18.

to PRIIPs as defined in the PRIIPs Regulation, but extends to any investment product available to him. The current limitations in scope seem quite arbitrary in this respect.

4.3. *Sales rules*

4.3.1. *Overview*

Next to information obligations, the second battlefield against regulatory arbitrage in the field of investment products, concerns the sales rules.

Although the PRIIPs Regulation introduces a limited number of such sales rules,[92] the most prominent directive in this respect is obviously the Markets in Financial Instruments Directive ("MiFID"). The MiFID sales rules – better known as "conduct of business rules" – introduced a harmonized duty of care, elaborate information duties, rules requiring investment firms to actively assess the suitability or appropriateness of financial instruments for a particular investor ("know-your-customer"), and rules requiring investment firms to achieve best execution of client orders,[93] besides rules on how to prevent conflicts of interest from damaging clients' interests.[94] The MiFID has recently been replaced by the MiFID II,[95] further enhancing and detailing those conduct of business rules.

The scope of application of the MiFID was limited to "financial instruments", including transferable securities,[96] money-market instruments,[97] units in collective investment undertakings, and different kinds of derivative contracts.[98] Not covered by the MiFID were, among other things, deposits and insurance products. In order to level the playing field with respect to sales rules, the MiFID II has (partly) expanded the scope of application of

92. The Regulation sets out that a person advising on or selling a PRIIP should provide retail investors with the KID in good time before those retail investors are bound by any contract or offer relating to that PRIIP (Art. 13 PRIIPs Regulation) and provides some rules with respect to marketing communications (Art. 9 PRIIPs Regulation).

93. Art. 19 –21 of MiFID I 2004/39/EC, as recently replaced by Art. 24–25 of MiFID II 2014/65/EU. On the MiFID II conduct of business rules, see Moloney, op. cit. *supra* note 9, pp. 800–808 and 810–814.

94. Art. 18 (1) and (2) and Art. 13 (3) MiFID I; Art. 23 and Art. 47 MiFID II. See on these rules Moloney, op. cit. *supra* note 9, pp. 808–809.

95. Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, O.J. 2014, L 173/349.

96. See definition in Art. 4 (1) MiFID II.

97. Ibid.

98. See annex I, C MiFID II.

certain provisions, including the conduct of business rules, to cover structured deposits also.[99]

The sales rules for the only category of PRIIPs still not covered by MiFID II,[100] the "insurance-based investment products", were, until recently, much less developed. The Insurance Mediation Directive ("IMD") merely provided for some basic information and know-your-customer obligations.[101] In order to avoid, with respect to sales rules, regulatory arbitrage between PRIIPs which are subject to MiFID II and PRIIPs which are not, the EU legislature planned to mirror the MiFID conduct of business rules in a fully revised IMD II.[102] As no agreement could be reached on the IMD II proposal by the time MiFID II had reached the end of the legislative process, MiFID II has amended the IMD I and introduced, for the time being, a separate chapter with "MiFID-like" conflicts of interest and conduct of business rules for insurance-based investment products.[103] Meanwhile the discussions on a full revision of IMD reached an end in July 2015, and "IMD II" was renamed

99. Art. 1, para 4 MIFID II.

100. The situation of UCITS funds and other collective investment undertakings – also a category of PRIIPs – is somewhat particular. If units in these funds are distributed by a credit institution or an investment firm, the MiFID conduct of business rules should obviously be complied with. Under MiFID I, Member States however had the discretion to decide whether to apply the MiFID conduct of business rules to legal persons which fulfil the following three conditions: (i) they only receive/transmit orders in UCITS, (ii) they do not hold any client funds, and (iii) they only transact with certain counterparties. MiFID II requires that such persons are at least submitted to rules that are equivalent to a selection of MIFID II rules, including the conduct of business rules (Art. 3). Art. 2 (i) of MiFID II reiterates the MiFID I exemption to the MiFID scope of application for "collective investment undertakings and pension funds whether coordinated at Union level or not and the depositaries and managers of such undertakings". This exemption has been interpreted in the sense that if units in a UCITS funds or other collective investment undertaking are distributed by the fund itself, without investment advice or individual portfolio management, MiFID does not apply. Under MiFID I certain Member States have nevertheless opted to apply MiFID-like conduct of business rules in such a situation, in order to level the playing field. See under MiFID I: Janin, "MiFID impact on investment managers", 15 *Journal of Financial Regulation and Compliance* (2007); Casey, "Shedding light on the UCITS-MiFID nexus and potential impact of MiFID on the asset management sector", ECMI Policy Brief No. 12, April 2008.

101. Arts. 12–13 IMD.

102. See the explanatory memorandum to the IMD II-proposal, 2: "In order to ensure cross-sectoral consistency, the European Parliament requested that the revision of IMD1 would take into account the ongoing revision of the Markets in Financial Instruments Directive (MiFID II). This means that, whenever the regulation of selling practices of life insurance products with investment elements is concerned, the proposal for a revised Directive (IMD2) should meet the same consumer protection standards as MiFID II".

103. Art. 91 MiFID II Directive; see also the Explanatory Memorandum to the IMD II Proposal at 11, explicitly mentioning that conduct of business rules for investment insurance products are based on the MiFID II conduct of business rules; Proposal for a Directive of the European Parliament and of the Council on insurance mediation (recast), COM(2012)360, at 11.

"Insurance Distribution Directive" or "IDD".[104] In the IDD, the conduct of business rules for insurance-based investment products have been aligned to MiFID II to a much greater extent.[105]

4.3.2. *Evaluation*

Contrary to the PRIIPs approach to information obligations, the legislative approach with respect to conduct of business rules remains essentially sector-driven. Existing sectoral legislation, in particular the MiFID and the IMD/IDD,[106] has been modified and brought in line with one another (the idea being that the IMD/IDD should follow the MiFID model).

The European legislature thus attempts to deal with the dangers and risks of regulatory arbitrage with respect to sales rules *within* the pre-existing sectoral framework. This approach however testifies to short-termism. In order to achieve something that could pass for a long-term level playing field, future developments in MiFID II will need to be meticulously transposed to the IDD and vice versa. Whether this result will be achieved and regulatory arbitrage at the expense of the retail investor avoided in the long run, remains doubtful. As an illustration, one could just think of the recent difficulties in amending both the MiFID and the IMD in concurrent legislative processes. As discussions on IMD II took much longer than it took to reach agreement on MiFID II, MiFID II has provisionally amended IMD I to introduce certain changes with respect to conduct of business rules for life insurance products already, awaiting an agreement on a full revision of that Directive. Meanwhile, however, negotiations on IMD II were continuing. Securing the level playing field between IMD II and MiFID II conduct of business rules did not seem of the highest concern during those discussions. Just one example is the rules with respect to cross-selling practices: Article 24(11) of the MiFID II provides for information obligations if a financial institution engages in cross-selling practices. The IMD II proposal in this area, however, provided for totally different rules. It distinguished between tying and bundling, and prohibited, in

104. This new name expresses the fact that the IDD rules no longer only apply to insurance brokers or intermediaries ("mediation"), but also to insurance companies that engage in direct selling, and thus to anyone distributing insurance products. See European Commission, "Press Release: Commission welcomes deal to improve consumer protection for insurance Products", IP/15/5293, July 2015.

105. The text agreed upon by Council and Parliament testifies such alignment, see Proposal for a Directive of the European Parliament and of the Council on insurance mediation (recast), 2012/0175 (COD), 16 July 2015, at <data.consilium.europa.eu/doc/document/ST-10747-2015-INIT/en/pdf>.

106. As rules of conduct with the purpose of consumer protection lag behind in the subsector of credit institutions. See Special Report of the European Court of Auditors, op. cit. *supra* note 61, 32–33.

principle, tying but not bundling.[107] Even the terminology used and the terms defined differed.[108] Only in the very last phase of the legislative process were the provisions of the IDD brought in line with MiFID II. There are still many smaller differences between the two legal texts, the justification of which is not always clear. The IDD moreover explicitly provides that its provisions, including those on cross-selling practices, only aim at minimum harmonization, whereas MiFID II generally aims at maximum harmonization.

The above already shows that although the applicable conduct of business rules are highly similar today, it is very difficult to ensure consistency in two concurrent legislative procedures with different lobby groups and interests influencing the process. Moreover, as the IDD aims at minimum harmonization, national differences in conduct of business rules for insurance-based investment products on the one hand and MiFID financial instruments and structured deposits on the other hand, will remain. To the extent these differences are not substantiated by differences in the economic purpose of these products, they are arbitrary and could result in regulatory arbitrage.

The fact that at EU level financial legislation continues to be interpreted and regulated by sectorally divided European Supervisory Authorities (ESAs), is not helpful in this regard. MiFID II and the IDD are the working field of ESMA and EIOPA, respectively. These authorities advise the Commission on level 2 legislation and create important level 3 "soft law",[109] to guide the interpretation and application of the relevant rules by the national competent authorities. Even though an attempt has been made to level the legislative playing field with respect to conduct of business rules in the MiFID II and the IDD level 1 directives, the danger of divergent interpretations and application at levels 2 and 3 seems real. Indeed, today one can already observe that, whereas consultations on the PRIIPs Regulation technical standards are

107. Art. 21 (1) IMD II Proposal. See in this regard, Colaert and Peeters, "Combined offers" in Terryn, Straetmans and Colaert (Eds.), *Landmark Cases of EU Consumer Law: In Honour of Jules Stuyck* (Intersentia, 2013).

108. MiFID II only defines the more generic concept "cross-selling practices" (Art. 4 (1)); a concept not defined in the IMD II Proposal, which uses the more specific concepts "tying" and "bundling" defined in respectively Art. 2 (19) and (20).

109. "Level 2" and "level 3" refer to the Lamfalussy legislative method; a legislative technique used in European financial law to speed up the legislative process. It is based on the idea that only the principles should be agreed upon in the ordinary legislative procedure, involving a proposal by the Commission and co-decision by the Council and the European Parliament ("level 1 legislation"). The technical details are then delegated to the Commission which can adopt "level 2 legislation". At "level 3" the European Supervisory Authorities (ESAs), composed of representatives of supervisors of the Member States, develop guidelines and standards for a common interpretation of the level 1 and level 2 legislation and "level 4" finally consists of a compliance check by the Commission. See Lamfalussy et al., "Final report of the committee of wise men on the regulation of European securities markets", 15 Feb. 2001.

conducted by the Joint Committee of the three ESAs,[110] consultations on the MiFID II implementation are conducted by ESMA alone.[111] In order to ensure a true level playing field, EIOPA as the competent authority for IDD should have been involved in the consultation process on implementing measures for MiFID II. It can only be hoped that EIOPA, when advising on levels 2 and 3 with respect to the IDD, will duly take into account the work which will have been done by that time by ESMA.

The persistent sectoral legislative approach with respect to conduct of business rules indeed necessitates improved cooperation between the authorities involved with financial supervision if a true cross-sectoral level playing field is to be achieved in the long run.

It would be preferable however to have one cross-sectoral piece of legislation govern conduct of business rules with respect to any investment product in the broad sense. The obvious candidate would be the MiFID II, the scope of which could be broadened so as also to cover the "investment" aspects of insurance-based investment products. The IDD could in addition still apply to these insurance-based investment products in order to deal with any insurance aspects.

4.4. *Product banning*

4.4.1. *Overview*

Although not envisaged by the European Commission in its attempt to define a more horizontal approach to regulation, a more recent third pillar of investor protection, product banning, should in our opinion also be examined from this perspective.

After several Member States had taken steps to prohibit the sale of certain financial products to retail clients,[112] and EBA and ESMA had used their

110. E.g. Joint Committee of the European Supervisory Authorities, "Discussion paper: Key information documents for packaged retail and insurance-based investment products (PRIIPs)", JC/DP/2014/02, 17 Nov. 2014.

111. E.g. ESMA, "Consultation Paper: MiFID II/ MiFIR", ESMA 2014,549, 22 May 2014.

112. In the UK, the FCA has introduced a prohibition to sell contingent convertible instruments to retail clients: see FCA, "Temporary product intervention rules: Restrictions in relation to the retail distribution of contingent convertible instruments", Policy Statement PS15/14, Aug. 2014; Although the German BaFIN does not seem to go as far as a product ban, it considers CoCo's are (in general) "not suitable for active distribution to retail clients". See Tophoven, Becker, Yoo, "CoCo bonds: Risks for retail investors", BaFin Expert Article, 15 Oct. 2014, at <www.bafin.de/SharedDocs/Veroeffentlichungen/DE/Fachartikel/2014/fa_bj_1410_coco-bonds.html>; In Belgium it is forbidden to sell the following financial products to retail clients: life settlements, derivatives from virtual currencies and derivatives form unusual products, such as art, antiques, old wine or whisky, the value of which is difficult to determine risky or complex products; see Royal Decree of 24 April 2014 endorsing the FSMA regulation on the

consumer protection competences to issue warnings against certain products,[113] the European legislature recently gave the ESAs the power to proceed to outright product banning at the EU level. The MiFIR gives "product intervention powers" to ESMA and EBA in their respective fields of competence. This means that ESMA (with respect to financial instruments) and EBA (with respect to structured deposits) can temporarily prohibit or restrict in the EU (a) the marketing, distribution or sale of certain such products or (b) a type of financial activity or practice.[114] The PRIIPs Regulation gives the exact same power to EIOPA with respect to insurance based investment products.[115] The MiFIR and the PRIIPs Regulation further explicitly allow Member States' competent authorities, under certain conditions, to (continue to) prohibit or restrict the same products, activities or practices in or from their Member State.[116]

4.4.2. *Evaluation*

As with the conduct of business rules, the legislative approach to product banning is essentially sector-driven. It is in this respect counter-intuitive that, although the PRIIPs Regulation covers financial products originating from the three sectors, and its implementing legislation is prepared by the Joint Committee of the three ESAs, it only gives product banning competences to EIOPA, whereas ESMA and EBA have been given exactly the same competence in another piece of legislation, the MIFIR. In the spirit of the more horizontal approach to legislation, it would certainly have been more elegant if one provision in the horizontal PRIIPs Regulation had conferred such competence on the three ESAs, each in their respective sectoral field of competence.

From an efficiency perspective the current approach is in any event sub-optimal. Each of the ESAs has been given the competence to develop technical advice on "criteria and factors to be taken into account in applying

prohibition of commercialization of certain financial products to retail clients, *Belgian Official Gazette,* 20 May 2014; In France the advertisements and marketing material of certain structured funds and complex debt securities must include a specific warning: "The prospectus of this complex security has been endorsed by [name of regulator], however the AMF deems this product to be too complex to be sold to non-professional investors and has therefore not examined its marketing material", AMF Position No. 2010-05, Marketing of complex financial instruments, 15 Oct. 2010.

113. E.g. EBA and ESMA, "Investor warning: Contracts for difference (CFDs)", 28 Febr. 2013; EBA, "Warning to consumers on virtual currencies", EBA/WRG/2013/01, 12 Dec. 2013; ESMA, "Potential risks associated with investing in contingent convertible instruments", ESMA/2014/944, 31 July 2014.

114. Arts. 40–41 of Markets in Financial Instruments Regulation (EU), No. 600/2014.

115. Art. 16 of the PRIIPs Regulation.

116. Art. 42 MiFIR; Art. 17 PRIIPs Regulation.

product intervention powers", which should lead to a Commission legislative act at level 2 of the Lamfalussy procedure.[117] It should be noted that the Commission, when asking for EIOPA's advice, invited EIOPA "to cooperate closely and take into account the result of the work which has been already undertaken by ESMA and EBA in the context of the product intervention powers under Regulation (EU) No 600/2014".[118] Several respondents to the consultation preceding EIOPA's technical advice nevertheless pointed out unsubstantiated differences with the ESMA and EBA criteria and factors.[119] EIOPA seems to have taken these comments into account, and has justified in its feedback statement certain remaining differences on the basis of technical differences between life insurance products and other investment products.[120]

This again illustrates that a true level playing field between the three sectors is not only created by introducing the same rules in the level 1 directive or regulation, but depends to a large extent on the goodwill of the three ESAs to cooperate and come up with the same standards for the same situations in levels 2 and 3 of the Lamfalussy procedure. The fact that the ESAs have in this case finally come up with substantially the same "criteria and factors"[121] and have clearly benefited from each other's efforts in creating such technical advice, is reassuring. There are however no procedural safeguards for the future in this regard. Moreover this process leads to triplication in efforts, which seems inefficient, not to say a waste of resources.

An even more fundamental issue is that the sectoral division of powers in this area may create supervisory gaps:[122] if new products are created, will it always be evident which Authority is competent to take action? It is difficult to assess today whether this risk is indeed acute. Conceptually, it in any event again points to the inefficiency of three sectorally divided European Supervisory Authorities in the current economic context.

117. *Supra* note 109.

118. European Commission, "Letter to the chairman of EIOPA", 30 July 2014, at <eiopa.europa.eu/Publications/Requests%20for%20advice/C238A332.pdf>.

119. See e.g. the feedback statement in EIOPA, "Technical advice on criteria and factors to be taken into account in applying product intervention powers", EIOPA-15/564, 29 June 2015, at 8: "Other respondents welcomed the close alignment with MiFIR and questioned why EIOPA, for example, added 'significantly' to criterion iii.e when referring to selling outside the target market, which would be less strict than rules for other sectors".

120. Ibid.

121. ESMA, "Final report: ESMA's technical advice to the Commission on MiFID II and MiFIR", ESMA/2104/1569, 19 Dec. 2014, at 187–196; EBA, "Technical advice on possible delegated acts on criteria and factors for intervention powers concerning structured deposits under Art. 41 and 42 of Regulation (EU) No 600/2014 (MiFIR)", EBA Op/2014/13, 11 Dec. 2014; EIOPA, "Technical advice on criteria and factors to be taken into account in applying product intervention powers", EIOPA-15/564, 29 June 2015.

122. And overlaps, which, although inefficient, are probably less problematic.

5. Towards a more horizontal approach of financial law?

The above sections analysed several initiatives aiming at a more horizontal, or cross-sectoral, approach to financial legislation in the field of investor protection and financial supervision, as well as a number of shortcomings of the current situation. This raises the question, more generally, what the more adequate *model* of legislation (sectoral or cross-sectoral) and supervision (sectoral, integrated or twin peaks) would be. In a European context this debate can however not be separated from the question at what *level* – EU or Member State – the financial industry should be regulated and supervised.

5.1. *The more adequate level of financial legislation and supervision*

Financial *legislation* has already to a large extent been harmonized at the EU level, which is inevitable not only to create an internal market but also in view of financial globalization and in order to avoid regulatory competition. The question arises how much further this evolution should go.

Financial *supervision* on the other hand, is today still mainly in the hands of national supervisors, except for one recent notable exception: prudential banking supervision. Indeed, with the introduction of the Single Supervisory Mechanism, the European Central Bank has become the prudential banking supervisor for the eurozone. Prudential supervision on investment firms and insurance companies (and on banks in non-eurozone Member States), as well as conduct of business supervision on the three sectors remains national (section 3.2.1 above). This division of supervisory competences already indicates that the level of financial regulation and supervision should not necessarily be the same for prudential and conduct of business matters.[123] In the next sections, first the level of *prudential* legislation and supervision is discussed and then the level of *conduct of business* legislation and supervision.

5.1.1. *Level of prudential legislation and supervision*

As the ECB is today, in principle, competent for prudential banking supervision in the eurozone, prudential banking legislation will almost inevitably evolve towards EU *regulations* instead of directives.[124] The current situation where the ECB needs to apply 19 national implementations of the

123. *Supra* notes 4 and 10 for definitions of these concepts.

124. This would be a further continuation of a pre-existing trend towards Europeanization of prudential regulation; see Dragomir, op. cit. *supra* not 10, p. 369.

Capital Requirements Directive[125] seems untenable in the long run. A "single rulebook" is therefore considered a crucial part of the Banking Union.[126]

The question arises whether it is a good idea to limit EU level prudential supervision and legislation to the banking sector only. During the crisis, large investment firms and insurance companies have proven to be equally vulnerable. Moreover there are investment firms and insurance companies of a size and systemic significance which raise supervisory issues very similar to those at the basis of the Single Supervisory Mechanism. We therefore believe that in the long run prudential supervision should be brought to the EU level for all financial institutions, irrespective of their sector (with delegation of tasks to national supervisors, as is currently the case in the banking sector). The corollary should be that prudential legislation in all three sectors should evolve towards a single rulebook with directly applicable EU regulations and binding regulatory technical standards.

5.1.2. *Level of conduct of business legislation and supervision*

With respect to conduct of business legislation and supervision, the situation is more nuanced. The EU for a long time only provided for a few basic conduct of business principles. Member States could introduce stricter legislation and rather easily deviate from the "home State control principle"[127] to protect "the general good".[128] With MiFID this national leeway has been heavily reduced, although limited exceptions to the principles of maximum harmonization and home State control are still possible.[129] Again the question arises whether an even more far-reaching form of EU intervention, by means of directly

125. A number of technical requirements were already transferred into a separate Regulation 575/2013 by the Capital Requirements Directive 2013/36/EU.

126. The Commission indeed claims in this respect that "[t]he new regulatory framework with common rules for banks in all 28 Member States, set out in a single rulebook, is the foundation of the banking union"; see Commission, "Banking union: restoring financial stability in the Eurozone", MEMO/14/294, 15 April 2014, at 2.

127. The home State control principle means that an investment firm which has been granted a licence by its Member State of establishment, can use this licence to provide services and establish branches in other Member States, while being supervised by its home State supervisory authority on the basis of the implementation of the relevant rules in the home State.

128. See Arts. 11 and 18(2) of Investment Services Directive 1993/22/EEC; Commission Communication to the European Parliament and the Council: Upgrading the investment services directive (93/22/EEC), COM(2000)729, at 3: "The usefulness of the single passport has been impaired by extensive exemptions from its scope and widespread application of host country requirements". This general good exception has therefore been labeled "the Trojan horse" of the ISD; see Bruyneel, "La réforme 1995–1997 des marchés et intermédiaires financiers", *Droit bancaire et financier* (1997), 520.

129. Art. 4 of the MiFID Implementing Directive 2006/73/EC; Moloney, *How to Protect Investors: Lessons from the EC and the UK* (Cambridge University Press, 2010), p. 210.

applicable regulations ruling out any Member State intervention, is needed in this area.

The traditional argument for still allowing limited national differences with respect to conduct of business legislation, is that retail market policy is deeply rooted in local markets,[130] so that Member States should be allowed to cater for cultural and economic differences. This would also leave room for regulatory competition and experimentation in an area where the best manner to protect investors has not yet been established.[131] From a legal perspective, a more convincing argument for favouring directives over regulations in the field of retail investor protection is the proportionality principle.[132] Whereas financial stability and systemic risk are overriding reasons to introduce EU regulations instead of directives, EU-wide unification of investor protection legislation is not dictated by a threat of systemic risk.

Already today, however, the idea that Member States should be able to adapt their financial legislation to cater for cultural and economic differences, is to a large extent illusory, as maximum harmonization directives prevail and Member States have only very limited leeway in adapting for instance the MiFID standards to their national markets. The PRIIPs Regulation shows that even the proportionality argument is quite easily set aside, with a doubtful but seemingly uncontested justification.[133] Ultimately one can indeed wonder whether the difference between a maximum harmonization directive and a regulation does not mainly lie in the emotional perception by the Member States.

As there are, in our opinion, no compelling arguments to introduce directly applicable EU conduct of business legislation, there does not seem to be a convincing case for conduct of business supervision by a European supervisor either.

130. E.g. Moloney, op. cit. *supra* note 129, pp. 100–101; Black, "Restructuring global and EU financial regulation: Character, capacities and learning" in Ferrarini et al., op. cit. *supra* note 42, p. 45.

131. Moloney, ibid., p. 101.

132. Art. 5 TFEU, recital 164 MiFID II.

133. See recital 4 to the PRIIPs Regulation: "A regulation is necessary to ensure that a common standard for key information documents is established in a uniform fashion so as to be able to harmonize the format and the content of those documents. The directly applicable rules of a regulation should ensure that all those advising on, or selling, PRIIPs are subject to uniform requirements in relation to the provision of the key information document to retail investors". It should be noted that, for example, both the Mortgage Credit Directive 2014/17/EU and the Consumer Credit Directive 2008/48/EC have introduced common standard information sheets on mortgage credits and consumer credits respectively, by means of a Directive (European Standardized Information Sheet or ESIS for mortgage credits, see recital 7, Art. 2, Annex II of the Mortgage Credit Directive and the Standard European Consumer Credit Information, see Annex II to the Consumer Credit Directive).

For these reasons I tend to support the current EU approach of introducing maximally harmonized conduct of business rules, with limited room for national deviations and with national conduct of business supervisors cooperating at EU level to coordinate interpretations.

5.2. *The more adequate model of financial legislation and supervision*

Irrespective of the *level* of legislation and supervision, the question remains what the ideal *model* of legislation and supervision would be in the current economic context. Should financial legislation remain sectoral or should the recent trend towards more horizontal legislation be pursued also in the field of prudential legislation? Should the European supervisory structure follow the trend of national supervisors and be reformed into a cross-sectoral system?

5.2.1. *Model of conduct of business legislation and supervision*

This contribution has shown that, in the field of investor protection, the most adequate answer to the phenomenon of blurring of sectors seems to be a horizontal approach to financial regulation. The need for principles-based legislation however increases as its object grows more diverse. The Lamfalussy method[134] allows to cater for such diversity, as is illustrated with the PRIIPs KID: the level 1 directive provides for principles which are sufficiently high-level to be applicable across the financial industry, whereas further fine-tuning, if needed per product or service (rather than per sector), would be possible at levels 2 and 3.

With respect to financial supervision, this contribution has further revealed that the current sectoral division of competences between three sectorally competent European Supervisory Authorities is inadequate. In view of the need for cross-sectoral investor protection legislation, one EU conduct of business Supervisory Authority would be more efficient. After cross-sectoral legislation has been implemented at levels 1 and 2 of the Lamfalussy approach, a single conduct of business Authority could indeed ensure that cross-sectorally consistent interpretation and application would also prevail at level 3, without having to triplicate the same advices and guidelines for the three sectors.[135] Moreover a single EU conduct of business Authority would also facilitate cooperation with national conduct of business supervisors (whatever the national model chosen) and would solve the problem that one of the ESAs might overly focus on prudential matters to the detriment of conduct

134. *Supra* note 109.

135. If needed, specific rules to cater for specific characteristics of certain products or services are obviously still possible.

of business issues or vice versa (both problems were developed in section 3.2.2.2).

For political reasons such an evolution is however not very likely to happen in the current European context (section 3.2.2.1, above).

5.2.2. *Model of prudential legislation and supervision*

The question arises whether a more cross-sectoral approach would also be preferable for prudential legislation and supervision.

The main activities and thus the risk profile of credit institutions, investment firms and insurance companies remain obviously different, so that differences in their prudential regimes are necessary. The main concepts on which prudential regulation is based are, nevertheless, the same. Many potential problems with a prudential impact are moreover the same or at least highly similar for the three sectors (e.g. risk assessment of assets, counterparty risk, management of operational risk, …).

Although the need for cross-sectoral prudential legislation has been given considerably less attention, it can therefore be argued that a more horizontal approach would be beneficial in this area as well. An IMF Working Paper comparing the Basel III standards for banks with the Solvency II Directive for insurance companies[136] indeed revealed that not all differences between those two sets of standards are justifiable by differences in the activities and risk profile of banks versus insurance companies.[137] When implementing the Basel III accord into the EU CRD IV package,[138] the Commission also pointed to the necessity to align the Solvency II Directive to the final text of the CRD IV package in order to avoid regulatory arbitrage.[139]

136. Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of insurance and reinsurance (Solvency II), O.J. 2009, L 335/1.

137. Al-Darwish, Hafeman, Impavido, Kemp and O'Malley, "Possible unintended consequences of Basel III and Solvency II", IMF Working Paper WP/11/187, Aug. 2011), at <www.imf.org/external/pubs/ft/wp/2011/wp11187.pdf>, at 17: "several differences in the two accords (as we will see in the next sections) are not supported by differences in the nature of capital needed in the two sectors, potentially generating unintended consequences".

138. In the latest (fourth) version of the Capital Requirements Directive 2013/36/EU, a range of technical requirements was transferred into a separate Regulation 575/2013. Both pieces of legislation are commonly referred to as the "CRD IV package".

139. Memo of the European Commission, "Capital Requirements – CRD IV/CRR: Frequently Asked Questions", 16 July 2013, at 28: "The corporate governance failings which contributed to the financial crisis occurred mostly in banks. Also, existing rules in the banking sector are of a very general nature as compared to insurance or investment fund legislation where rules on internal organization and risk management are much more detailed and precise. That is why we started with reforming corporate governance in credit institutions and investment firms. However, for the sake of consistency and in order to avoid regulatory arbitrage between sectors, it will be necessary to review the existing legislation in other sectors

In view of this assessment, the case for a single EU *prudential* supervisor for the three sectors is intuitively appealing. As the ECB is today already in charge of eurozone prudential banking supervision, the ECB would be the obvious candidate to become such a single prudential supervisor. In the European reality such a reform would however not only be politically sensitive, but also be confronted with legal obstacles. Article 127 TFEU explicitly provides that "the Council may . . . confer specific tasks upon the European Central Bank concerning policies relating to the prudential supervision of credit institutions and other financial institutions *with the exception of insurance undertakings*".[140] Attributing prudential supervision for the three sectors to the ECB, would therefore be impossible unless the TFEU were changed.

5.3. *Avoiding gaps and overlaps*

The notion implemented in the Single Supervisory Mechanism to divide supervisory powers between the European level (competent for prudential supervision) and the national level (competent for conduct of business supervision) can be supported. It should in our opinion however (i) be extended to the securities and insurance sectors; and (ii) have a legislative corollary. This cross-sectoral approach should make sure that the financial sector is regulated in a functional manner: all products, services and institutions involving the same type of risks, should be covered by the same type of regulation. This should avoid new types of products, services or institutions which pose the same risk not being covered.[141]

A functional division of powers – conduct of business supervision by national supervisors and prudential supervision by an EU supervisor – however creates the risk of other gaps, overlaps and inefficiencies if the division of competences is not crystal clear (section 3.1.2 above). Two

(Solvency II, UCITS Directive) to align it, when necessary, to the outcome of the final text of the CRD IV package. Nevertheless, the specificities of each sector should be taken into account, and the rules should not necessarily be identical for banks, insurance companies and investment funds".

140. Emphasis added.

141. With respect to banking regulation, see Armour et al., "Principles of financial regulation: Introduction", ECGI Law Working Paper No. 277/2014, Aug. 2015, at <ssrn.com/abstract=2526740>, 12: "…the scope of such regimes does not make sense unless defined in functional terms. The appropriate question is therefore not, 'what does the applicable legislation cover?', but rather 'what sorts of organizations give rise to problems of the regulation is seeking to address?' That is, not so much 'what is a bank?' but 'what ought to be regulated as a bank?' Likewise, what activities can be left to disclosure regimes on the grounds that the relevant actors can knowledgeably evaluate and manage risks themselves and what activities require active intervention because they cannot*?*" (see also at 14).

measures should mitigate these risks: (i) a detailed attribution of supervisory competences by clearly labelling financial law rules as conduct of business, prudential or, in some instances, both; and (ii) efficient cooperation and information sharing structures between the national conduct of business supervisors, the EU conduct of business Supervisory Authority, and the European prudential supervisor(s).

6. Conclusion

The traditional, sectoral approach to financial legislation and supervision in Europe is increasingly at odds with the blurring of boundaries between the banking, insurance and investment sectors. The resulting inefficiencies, incoherence, overlaps and blind spots have proven to be a fertile breeding ground for regulatory arbitrage. The "piecemeal approach" to legislation in the EU has exacerbated this situation.

Although Member States as well as the European legislature have taken initiatives attempting to solve this problem, a fool proof solution seems difficult to achieve.

In several *Member States* a first reaction to the problems associated with the blurring of sectors, was to reform the structures of financial supervision in order to ensure a consistent level of supervisory scrutiny across the financial sectors. The last decades have witnessed a clear tendency towards cross-sectoral supervisory models either by establishing a single supervisory behemoth monitoring any activity in the financial industry, or, recently even more frequently, a "twin peaks" model, with a functional division of supervisory powers between a prudential and a conduct of business supervisor. At the *EU* level, however, a sectoral supervisory structure was kept in place and reinforced, with different European Supervisory Authorities for the banking, securities and insurance sectors. Even though a Joint Committee was set up to deal with cross-sectoral issues, we have argued that this sectoral division of powers is sub-optimal in a European Union that is characterized by a blurring of sectors and where Member States increasingly adopt a twin peaks supervisory model.

The EU on the other hand did take a modest first step to orient its financial legislation towards a more cross-sectoral approach, by introducing standardized product documentation for "packaged" investment products regardless of their sectoral origin or legal form. Therein lies the PRIIPs Regulation's undeniable merit, despite its relatively limited scope. With respect to sales rules, however, instead of replacing sectoral legislation with one horizontal set of rules, the European legislature has made an attempt to level the playing field between sectors *within* pre-existing sectoral pieces of legislation. In the Insurance Distribution Directive (replacing the former Insurance Mediation Directive) the sales rules applicable to insurance-based investment products have been brought in line with the MiFID II conduct of business rules. The sectoral legislative approach has thus not been abandoned with respect to sales rules – nor with respect to product banning – which threatens to undermine the goal of creating a genuine and lasting level playing field for economically very similar products and services across the different sectors.

The shortcomings which we have identified with respect to recent changes in European financial supervision and legislation have finally led to conclusions about the level at which and model according to which financial legislation and supervision should be organized to optimally remedy the problems associated with the blurring of sectors and thereby improve investor protection and financial stability. In our opinion prudential legislation will, almost inevitably, be increasingly replaced by regulations, as the ECB has become the competent authority for supervising the banking sector and can hardly be expected to supervise financial institutions in accordance with 19 sets of implementations of the same directive. In our opinion prudential supervision and legislation of the insurance and securities sector should ideally also be shifted to the EU level. Although a single EU prudential supervisor for the three sectors would in our opinion further improve financial stability, political and legal hurdles make such evolution quite unlikely in the near future. With respect to conduct of business legislation on the other hand, the case for even more far-reaching EU legislation and supervision seems less compelling. A cross-sectoral Supervisory Authority, taking over the functions of the current European Supervisory Authorities with respect to conduct of business issues, would nevertheless improve efficiency.

A truly horizontal legislative and supervisory approach, rooted in economic reality rather than in the – considerably less relevant – legal form of financial institutions, services and products, seems however scarcely feasible in the current EU legal and political setting.

At Member State level, one Member State, the Netherlands, has attempted to overhaul the sectoral legislative approach and has introduced an integrated cross-sectoral legislation. It is however most questionable whether this ambitious reform is tenable in the long run in a context of ever more far-reaching European harmonization, which is and seems likely to remain mainly sectorally driven.[142]

142. In the same sense, see Grundmann-van de Krol, op. cit. *supra* note 8, p. 14.

Ultimately, divergences between the EU and national approaches to financial legislation and supervision threaten to obstruct well-functioning, stable markets, and deprive investors in the EU of the degree of protection they would be entitled to expect from such a gargantuan body of law and such an armada of supervisors.

COMMON MARKET LAW REVIEW

Subscription information
Online subscription prices for 2016 (Volume 53, 6 issues) are: EUR 773/USD 1097/GBP 555. Print subscription prices for 2016 (Volume 53, 6 issues):
EUR 818/USD 1157/GBP 583
Personal subscription prices at a substantially reduced rate are available upon request. Please contact our sales department for further information at +31 172641562 or at sales@kluwerlaw.com.

Payments can be made by bank draft, personal cheque, international money order, or UNESCO coupons.

Subscription orders should be sent to:

Kluwer Law International
c/o Turpin Distribution Services Ltd
Stratton Business Park
Pegasus Drive
Biggleswade
Bedfordshire SG18 8TQ
United Kingdom
e-mail: sales@kluwerlaw.com

or to any subscription agent

All requests for further information and specimen copies should be addressed to:

Kluwer Law International
P.O. Box 316
2400 AH Alphen aan den Rijn
The Netherlands
fax: +31 172641515

For Marketing Opportunities please contact marketing@kluwerlaw.com

Please visit the Common Market Law Review homepage at http://www.kluwerlawonline.com for up-to-date information, tables of contents and to view a FREE online sample copy.

Microfilm and Microfiche editions of this journal are available from University Microfilms International, 300 North Zeeb Road, Ann Arbor, MI 48106, USA.

The Common Market Law Review is indexed/abstracted in Current Contents/Social & Behavioral Sciences; Current Legal Sociology; Data Juridica; European Access; European Legal Journals Index; IBZ-CD-ROM: IBZ-Online; IBZ-lnternational Bibliography of Periodical literature on the Humanities and Social Sciences; Index to Foreign Legal Periodicals; International Political Science Abstracts; The ISI Alerting Services; Legal Journals Index; RAVE; Social Sciences Citation Index; Social Scisearch.