

THE CHALLENGES OF PROTECTING CONSUMER IN THE DISTANCE MARKETING OF FINANCIAL SERVICES DIRECTIVE

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Abstract

The European Commission's new rules presented in its Digital Finance Package at September 24, 2020, introduce much-needed improvements for the online retail financial services market which will strengthen consumer protection. However, additional new rules are needed in some key areas. On May 11, 2022, the EU Commission published a directive proposal amending Directive 2011/83/EU on consumer rights (the „Consumer Rights Directive“ – CRD) and repealing Directive 2002/65/EC concerning the distance marketing of consumer financial services. The European Commission's legislative proposals are a very welcome step in the right direction to better protect consumers in the increasingly digital financial services market. While digitalisation brings opportunities for suppliers and consumers alike, it also brings a number of risks, making a proper regulation of the market necessary not only by updating it but strengthening consumers' rights, by filling existing regulatory gaps in the online financial services market. Financial services are very different from other consumer goods and services covered by the CRD and therefore creating a specific chapter and rules for financial services is crucial. At the European level, there are numerous regulations across this area. The regulatory failure results first and foremost from the lack of adequate consumer protection standards and enforcement failings at Member State level. While the Commission's proposal brings key improvements, some much-needed measures are missing and their absence represents real challenges for effective consumer protection. This paper aims to show what are the aspects that need to be improved in the Commission's proposal and how to proceed in order to create a high level of protection and a fair financial services market, and each matter will be illustrated with examples from various Member States, including Romania how the gaps in current legislative framework have detrimental effects for consumers.

Keywords: consumer protection, financial services, digitalization, risks, Directive 2002/65/EC.

1. Introduction

The Directive 2002/65/EC¹ of the European Parliament and of the Council of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC (DMFSD) provides a legal framework governing the distance marketing of financial services.

The DMFSD aimed to ensure the free movement of financial services and the harmonization of consumer protection rules. By laying down rules on (i) the information that consumers must receive before concluding a distance contract²; (ii) introducing a 14-day right of withdrawal (iii) and by regulating unsolicited distance sales and communications, it has increased the protection of consumers purchasing financial services³ at a distance⁴. It is indisputable that, through the results obtained after the adoption of the DMFSD, the conditions for users of financial services have improved. However, financial integration has a much greater stake, consisting in creating a solid framework for the adequacy of the stability of the financial system as a whole.

¹ <https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:32002L0065>.

² According to DMFSD, distance contract „means any contract concerning financial services concluded between a supplier and a consumer under an organised distance sales or service-provision scheme run by the supplier, who, for the purpose of that contract, makes exclusive use of one or more means of distance communication up to and including the time at which the contract is concluded“.

³ In DMFSD, „financial service“ means any service of a banking, credit, insurance, personal pension, investment or payment nature.

⁴ According to DMFSD, „means of distance communication“ refers to any means which, without the simultaneous physical presence of the supplier and the consumer, may be used for the distance marketing of a service between those parties.

2. The Commissions' evaluation of the DMFSD

In step with digitization, in the last two decades, the distance selling of financial services for consumers has changed rapidly and substantially, given that new players, new business models and new distribution channels have appeared. Consumers are now increasingly inclined to use the tools of the digital world. The Covid-19 pandemic and the restrictions that accompanied it accelerated this process, which made it necessary to revise the relevant European Union legislation in this field.

Anyway, just before the pandemic, the Commission released a roadmap to evaluate the DMFSD.

Figure 1. The EC roadmap to evaluate the DMFSD, source KPMG



One of the objectives pursued was evaluating the DMFSD in light of increased digitalisation in the financial services market and the development of product-specific and horizontal legislation (e.g., GDPR no. 2016/679).

The evaluation concluded that «the DMFSD and its objectives have been achieved to some extent, however a number of areas in which it could be improved where identified:

- Articles regarding pre-contractual information do not fully address the increase in digitalisation;

The provisions regarding the right of withdrawal are still effective to a certain extent and could be better implemented if additional mechanisms have been created, so that consumers can use this right more efficiently. As in the case of the provisions regarding the pre-contractual information, the correlation of these provisions with the specific and horizontal legislation could be clarified to avoid the legal uncertainty;

- The cross-border market for financial services remains limited due to a number of issues: language barriers, consumer uncertainty and differing tax regimes;

- One of the main issues is the inconsistency of the laws on certain aspects, such as establishing the purpose and scope of the law that transposes the directive on distance financial services or defining the moment of conclusion of contracts, as well as the provisions regarding the protection of personal data, do not confer predictability, a unitary approach and or does not provide equal treatment in the relationship between professionals and in the relationship with consumers. Later on in this study we will illustrate with examples from Romanian legislative framework and some jurisprudence cases in this regard.

- Also, the poor use of the extrajudicial means of resolving disputes, caused by insufficient digitalization or lack of information regarding this tool, makes these facilities inoperative.

- Although the relevance of the Directive and the value it adds has decreased with the introduction of product specific and horizontal legislation, it still acts as a „safety net” for products which do not have associated product additional legislation in order to protect consumers. However, the use of this feature is minimal».

In 2020, the EU Commission, in a staff working document, pointed out that the DMFSD had been only partially effective and had contributed in a limited way to the consolidation of the EU single market, due to internal and external barriers. The Commission observed that the ongoing digitalisation process had changed the consumer credit market (the growth of e-commerce), the wider digitalisation trends, new developments in

financial technology (*i.e.*, FinTech's and crypto assets) had exacerbated some aspects of the distance marketing of consumer financial services, not fully nor touched addressed by the DMFSD.

Added to this is the fact that the introduction of EU product-specific legislation has created significant overlaps, thus leading to both legal and practical difficulties in applying the DMFSD, which therefore seems outdated and no longer relevant in the context of recently-enacted EU legislation governing the field.

3. Regulation of the distance selling of financial services in the World

As we know, in the EU, the rules with the objectives to protect consumers when they sign a contract with a retail financial services provider at a distance (*e.g.*, via phone or online) have been established in 2002 under the DMFSD. Outside the EU, we will illustrate with a few aimed at protecting consumers.

The Dodd-Frank Act constitutes the most significant reform of financial regulation in the United States since the 1930s. In USA, there are numerous agencies assigned to regulate and oversee financial institutions and financial markets in the United States, including the Federal Reserve Board (FRB), the Federal Deposit Insurance Corp. (FDIC), and the Securities and Exchange Commission (SEC). The FED, for instance, „is committed to promoting fair and transparent financial service markets, protecting consumers' rights, and ensuring that its policies and research take into account consumer and community perspectives”⁵.

The governmental approach to e-commerce and financial services to consumers in the United States could be considered as „light touch' regulation”. The advertising or selling of financial services products to consumers or to businesses via the internet are regulated by various regulations⁶. For instance:

- Regulation Z (the Truth in Lending Act) requires certain disclosures for consumer credit and lease terms in open end credit, closed end credit and credit/charge cards;
- Regulation DD (the Truth in Savings Act) requires specific information regarding advertisement of deposit accounts.;

According to the FDIC Rules & Regulations, members promoting deposit products and non-specific banking products must identify as FDIC members. Where a FDIC member bank advertises investment or insurance products, it must disclose that the product is not FDIC insured and may lose value.

As one example, for e-commerce in China, the State Administration for Market Regulation (SAMR) issued rules on online transactions in March 2021 to „protect the legitimate rights and interests of online consumers” by offering protection against online merchants following deceptive or misleading practices, such as fake transactions and user reviews, and false marketing⁷.

4. Romanian situation

In the last two decades, the remote sale of financial services for consumers has changed rapidly and substantially, given that new players, new business models but also new distribution channels have appeared. Consumers are increasingly inclined to use the tools of the digital world, and the Covid-19 pandemic and the restrictions that accompanied it accelerated this process, which made a revision of the relevant legislation of the European Union in this field.

According to the European Commission⁸, the new proposal amending rules concerning financial services contracts concluded at a distance aims „to simplify and modernise the legislative framework by repealing the existing DMFSD while including relevant aspects of consumer rights regarding financial services contracts concluded at a distance within the scope of the horizontally applicable Consumer Rights Directive. The overall objective of the legislation remains unchanged: to promote the provision of financial services in the internal market while ensuring a high level of consumer protection”.

Digitalization is an increasingly present topic in all fields of activity, regarded as a necessity, as a need to adapt the entire system to the progress of the society and to the technological realities of today. In the field of financial services, digitalization not only increased the performance of activities, but has solved requirements regarding transactions from anywhere and anytime.

⁵ <https://www.federalreserve.gov/publications/2021-ar-consumer-and-community-affairs.htm>.

⁶ For an extended list of USA regulation see <https://www.lexology.com/library/detail.aspx?g=385c70d8-0dc5-40aa-8eb0-d3f52b55bbd4>.

⁷ <https://www.bis.org/fsi/publ/insights36.pdf>.

⁸ https://finance.ec.europa.eu/consumer-finance-and-payments/retail-financial-services/distance-marketing-financial-services_en.

However, the legal aspects of the conclusion of financial services contracts for consumers behave certain particularities and require increased attention regarding the application of the principles of law specific to the European Union legislation, but also of the various Member States where the contracts are concluded.

On May 11, 2022, the European Commission adopted a proposal to reform the European Regulatory Framework Governing Financial Services Contracts (the Proposal). The Proposal Would Strengthen Consumer Rights and Foster the Cross-Border Provision of Financial Services in the Single Market.

In Romania, the main normative act in this matter is GO no. 85/2004 regarding the protection of consumers at the conclusion and execution of distance contracts regarding the financial services, as well as by the newer regulation of the GEO no. 34/2014 regarding the rights of consumers within the contracts concluded with the professionals, as well as for the modification and completion of some normative acts.

GO no. 85/2004 in particular regulates „the conditions of information of consumers in order to conclude and execute the remote contracts regarding the financial services”.

However, in Romania legislation is found at the moment the existence of overlaps or over-regulations within the legislative framework regarding electronic trade.

Thus, there are several regulations containing provisions regarding electronic trade:

- specific regulations, respectively the Law no. 365/07.06.2002 on Electronic Trade, which transposes Directive 2000/11/EC regarding certain legal aspects regarding the services of information society, in particular electronic trade in the internal market, published in the Official Journal of European Communities no. L 178/2000;
- general regulations, regarding trade, which are also applicable to online trade.

Although we have this legislative framework created by a long period of time, we observe, in the financial market, reluctance to the credit agreements concluded at a distance, the fears, probably, coming from the difficulties of proving the legal relations.

Art. 2 points 7 of GEO no. 34/2014 defines the distance contract as „any contract concluded between professional and consumer, within a system of sales or remote services, organized, without the simultaneous physical presence of the professional and the consumer, with the exclusive use of one or of several means of remote communication, up to and including when the contract is concluded.” A similar definition is included in art. 3 letter a) from GO no. 85/2004, regarding the contracts in the financial field: „distance contract – the contract for the provision of financial services concluded between a provider and a consumer, within a system of sale at a distance or of a service provision organized by the provider which uses exclusively, before and at the conclusion of this contract, one or more remote communication techniques”.

The remote communication technique means „any means that, without requiring the simultaneous presence of the two parties, consumer and supplier, can be used for marketing or remote promotion of financial services”.

At the European level, the moment of the conclusion of the contract is not regulated by means of remote communication or the moment of the conclusion of the contract by electronic means. In the Romanian legislation, at national level, through Law no. 365/2002, the moment of the conclusion of the contract by electronic means, if the parties have not agreed otherwise, is given by the moment when the bidder has become aware of the acceptance of the offer to contract.

At the same time, through GEO no. 34/2014, the moment of the conclusion of the contract by means of remote communication, except for the electronic means, is given by the moment of confirmation, on a sustainable support, by the professional of accepting the order transmitted by the consumer, without the possibility to derogate from this moment. GEO no. 111/2011 regarding the electronic communications, provides in art. 55 para. (9), the fact that „the moment of the conclusion of the distance contract is the moment of confirmation, on a sustainable support, by the supplier of accepting the order transmitted by the end user”.

This regulatory method has the shortcoming to allow the supplier to establish, as desired, the moment of the conclusion of the contract, remaining at its latitude when it confirms, on a sustainable support, the acceptance of the order transmitted by the end user. Therefore, in order to establish an increased level of predictability of the law, a unitary approach to the moment of the contract is required, both if the electronic means are used and if other means of remote communication are used.

Also, for a better legislative coherence and in order to ensure a more predictable legislative framework, the moment of the conclusion of the contract should be treated unitary, both in the relationship between professionals and in the relationship between consumers.

A special issue is that of the validity of the contracts of financial services concluded at a distance and the moment of the conclusion, in situations such as the forced execution of consumers who do not comply with the obligations assumed in the framework of financial services concluded.

The provisions of art. 120 of the GEO no. 99/2006 regarding credit institutions and capital adequacy provide: „credit contracts, including real or personal guarantee contracts, concluded by a credit institution constitute enforceable titles“.

Since the contracts concluded with the non -bank financial institutions represent enforceable titles, in case of non-reimbursed loans, these entities can resort to any legal form of forced execution. The enforceable title of the credit agreement and the real and personal guarantees confers the right of the non-bank financial institution that, in the situation of non -reimbursing by the consumer the contracted loan or as a result of declaring the anticipated maturity of the credit agreement, to proceed to its forced execution from Following, through all the forms of execution provided by the legal provisions in the matter. The forced execution can only start at the request of the creditors, according to the Civil Procedure Code. Their request must be submitted or transmitted to the competent judicial executor, together with all the necessary supporting documents, in order to approve the enforced execution by the court.

We note that, so far, there has not been a jurisprudence in the matter of the execution disputes started on the basis of the enforceable titles consisting of credit contracts, concluded at a distance. In fact, this kind are quite rare. Our assumptions are that, often, suppliers of such services mask the fact that the respective contract has been concluded at a distance and formulates the contract on paper, which we send to the consumer for signing by courier or by post, so in the case of a dispute. to present the record of the debt, in original.

Thus, in a case having as object the forced execution, the first court ruled in the sense of approving the forced execution in appeal, by the civ. dec. no. 1049/10.10.2016, basically the request for approval being rejected because the credit agreement was not signed by the borrowed, next to the signature being passed the mention „signed electronically“, the substantive court considering that the qualified certificate issued to the borrower was not submitted, to attest the authorization of the extended electronic signature regarding it.

Regarding the moment of the conclusion of the contract, one county tribunal, by which, in the appeal, the forced execution of a credit agreement concluded at a distance, after the request for approval had been rejected. The first court, considers that the moment of the conclusion of the contract was not demonstrated, although the request for lending was concluded by the online consumer, the request was approved by the supplier on the spot and the amount borrowed was transferred to the account indicated by the consumer.

5. The aspects that need to be improved in the Commission's proposal. Instead of Conclusions

The European Commission proposal which is being discussed within the Council and European Parliament is a welcome change.

The pre-contractual stage is very important, in which the consumer must be very detailed and correctly informed about the financial products ordered, this information being, at the same time, a tool in favor of the providers of financial services regarding compliance with consumer protection legislation, making sure the customer has all the right information to make an informed decision on their purchase of the financial product.

In conditions of transparency and secure communication between the parties, prior to the completion of the contract concluded at a distance, this represents a safe and advantageous means of obtaining credit by consumers. The introduction of appropriate provisions to ensure that consumers receive the necessary and appropriate explanations regarding financial services and products before purchasing them through online tools, roboadvisors, live chat, Q&A, chatbots and other similar tools are requirements that must be met. Also, the proposals should include a right for consumers to request human intervention in cases where online tools such as robo-advisers are used by providers.

What is missing at the moment in DMFSD is the regulation of the activity of influencers in the Financial Services marketing, known as FinFluencers. A financial influencer or 'FinFluencer', is a person who gives information and advice to investors on financial topics, usually on stock market trading, personal investments like mutual funds and insurance, primarily on various social media platforms. The project to review DMFSD has failed to cover the protection of consumers against the risks that social media and FinFluencers pose to consumers and financial stability.

Influencer marketing in financial services is widespread across Europe. According to research by the International Organization of Securities Commissions, 43% of European firms plan to increase use of influencers as a marketing tool⁹. Moreover, due to the digital environment in which they operate, fintech companies are less constrained by geographical barriers.

But right now, this practice is not regulated at EU level, leaving consumers unprotected. There are documented cases when EU citizens have lost a lot of money due to aggressive social media advertising by social media influencers of crypto assets¹⁰.

It should be noted that the Commission's proposal addresses online fairness. Increasingly, financial service providers are using techniques such as "dark patterns" that take advantage of consumer behavioral biases. Dark patterns are some deceptive methods of using the online interface, such as, for example, the coloring of the decision buttons or the position and order in which the options are placed on the page, which have the role of tricking consumers into making decisions that are in the interest of the online business, but at the expense of the user. These practices must be properly regulated to protect consumers against mis-selling and the new proposal for the directive must cover all these aspects of consumer protection of financial services contracted through distance means.

Another problematic issue is related to the EU framework. The fragmentation of the consumer credit legislation in the EU, which limits the impact of the Directive on legal clarity, and the considerable differences in enforcement tools and remedies used by competent authorities, present a significant obstacle to the development of a well-functioning internal market for consumer credit. In the EU single market, a high level of protection in distance marketing of financial services is key in order to protect consumers' freedom and equality of choice. This being possible solely through a full harmonisation of EU law governing the field, and within the Member States.

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