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Transnational Fiduciary Law in Financial Intermediation: Are We There Yet?

A Case Study in the Emergence of Transnational Legal Ordering

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4.1 INTRODUCTION

In both common and civil law jurisdictions, fiduciary duties (in the broadest sense) have long been recognized as a key element of the relationships between financial intermediaries and their customers. If one defines fiduciary relationships as including "important social and economic interactions of high trust and confidence that create an implicit dependency and peculiar vulnerability of the beneficiary to the fiduciary" (to borrow a definition suggested by Leonard Rotman),[1] a broad range of financial services clearly match the description.[2] From a comparative – and,

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[1] Leonard I. Rotman, *Understanding Fiduciary Duties and Relationship Fiduciarity*, 62 McGill L.J. 975, 988 (2017).

[2] It should be noted that this definition, although firmly rooted in common law doctrine, is generic in nature. At least English cases traditionally have determined the existence of fiduciary duties by reference to the status of the relevant relationships (trustee-beneficiary, solicitor-client, agent-principal, director-company, partner-partner), while only a smaller number of cases have adopted a functional definition; *see*, within the present context, Law Comm'n, Consultation Paper No. 124, Fiduciary Duties and Regulatory Rules (1992), ¶¶ 2.4.3–2.4.7. For an example of the latter, which is broadly consistent with the definition advanced above, *see* Reading v. Attorney-General [1949] 2 KB 232 at 236, *approved*, [1951] AC 507 (discussed in Law Comm'n, *id.* ¶ 2.4.5):

> [T]he term 'fiduciary relation' … is used in a very loose, or at all events a very comprehensive, sense … . [F]or the present purpose a 'fiduciary relation' exists (a) whenever the plaintiff entrusts to the defendant property … and (b) whenever the plaintiff entrusts to the defendant a job to be performed … and relies on the defendant to procure for the plaintiff the best terms available. …

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particularly, from a Trans-Atlantic perspective – a useful starting point for analysis can be found in the statutory definitions of financial activities subject to specific prudential and conduct-of-business regulations. Wherever intermediaries hold money or other assets on behalf of clients in connection with transactions carried out on their behalf,[3] or agree to provide expert advice with regard to investments[4] or the conditions of a loan taken out by a customer,[5] the existence of both a high level of trust *and* a high level of dependency and vulnerability on the part of the client is not just a characteristic feature of the intermediary-customer relationship, but provides the very rationale for public intervention, particularly in the form of conduct-of-business regulation. From a common law perspective, such activities usually will be qualified as agency relationships, which, given the functional nexus between fiduciary law and the law of agency in common law generally,[6] helps explain why common law courts have frequently held that financial intermediaries are under fiduciary duties of loyalty and care, as well as duties to disclose certain information, to their customers.[7] This doctrinal analysis can be backed up by an economic analysis of the agency problems between the intermediary (acting as

[3] Qualifying as an "ancillary service" in relation to the provision of "investment services" pursuant to European Parliament and Council Directive 2014/65/EU, Annex I, Section B no. (1), 2014 O.J. (L 173) 349 [hereinafter MiFID II]. In US law, by contrast, the Securities Exchange Act applies a rather broad concept to define a "broker" as "any person engaged in the business of effecting transactions for the account of others." 15 U.S.C.A. § 78c (a)(4)(A) (Westlaw through Pub. L. No. 117-167).

[4] Qualifying as an "investment service" pursuant to Annex I, Section A no. (5) in conjunction with art. 4(1)(2) MiFID II, *supra* note 3. In US law, the provision of investment advisers is addressed by the Investment Advisers Act of 1940; *see* 15 U.S.C.A. §§ 80b–1 et seqq. (Westlaw through Pub. L. No. 117-167).

[5] Unlike investment advice, the provision of advice with regard to the conditions (and/or uses) of a loan to a borrower is not universally regulated as a financial service and thus does not give rise to specific regulatory duties on the part of an intermediary, but may nonetheless held to be subject to special duties of care under fiduciary law or general principles of contract law. *Cf.*, *e.g.*, Andrew F. Tuch, *Fiduciary Principles in Banking*, *in* The Oxford Handbook of Fiduciary Law 125, 128 (Evan J. Criddle et al. eds., 2019) (discussing US case law); Jens-Hinrich Binder, *Germany*, *in* A Bank's Duty of Care 61, 63–65 (Danny Busch & Cees van Dam eds., 2017) (discussing the legal basis in German law and relevant cases).

[6] *See*, *e.g.*, Deborah A. Mott, *Fiduciary Principles in Agency Law*, *in* Criddle et al., *supra* note 5, at 23. *See also* Howell E. Jackson & Talia B. Gillis, *Fiduciary Law and Financial Regulation*, *in* Criddle et al., *supra* note 5, at 856. *Cf.* Marme Inversiones 2007 v. NatWest Markets PLC and Others [2019] EWHC (Comm) (QB) 366 [408]–[417] (providing an in-depth analysis of the doctrinal link between the two concepts from an English law perspective).

[7] *See also* Thomas Lee Hazen, The Law of Securities Regulation 632–39 (7th ed. 2017); Donald C. Langevoort, *Fraud and Deception by Securities Professionals*, 61 Tex. L. Rev. 1247, 1279–83 (1983); *cf.* Tuch, *supra* note 5 (comprehensively analyzing of US case law in relation to commercial and investment banking activities); Arthur B. Laby, *Fiduciary Principles in Investment Advice*, *in* Criddle et al., *supra* note 5, at 145 (comprehensively analyzing of US case law in relation to the provision of investment advice). English courts have also recognized the fiduciary nature of broker services; *cf.*, *e.g.*, Brandeis (Brokers) Ltd v. Herbert Black and Others, 2001 WL 513189 (QB), ¶¶ 49 and 52.

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"agent" for less knowledgeable investors) and the customer (as a "principal" who, almost by definition, can hardly protect himself against the fallout from information asymmetries and conflicts of interest on the part of the former).[8] Even in civil law jurisdictions, where the legal basis for financial services contracts usually consists of, or is derived from, statutory categories of general contract law,[9] the concept of fiduciary duties increasingly has come to be accepted as an analytical framework.[10] For a number of reasons to be explored in detail later, both the substantive laws pertaining to the provision of financial services and, indeed, their doctrinal interpretation can be seen to have converged in a large number of jurisdictions over the last few decades.

With international standard-setters – in particular, the International Organization of Securities Commissioners (IOSCO) – as a driving force behind these developments,[11] the emergence of an increasing body of an internationally agreed-upon set of standards applicable to intermediary-customer relationships in financial services seems to showcase transnational legal ordering, in terms of the causes of convergence and the underlying institutional arrangements that facilitate the transmission process, as well as the substance of such duties and their adaptation in different legal systems. On closer inspection, however, the picture is more nuanced. As rightly observed in a recent contribution by Howell Jackson and Talia Gillis, we have to distinguish between the regulatory regimes applicable to the provision of financial services, consisting of "elaborate set[s] of *ex ante* requirements and supplemental open-ended duties that govern the operations of regulated entities and police their interactions with the public," on the one hand, and parallel, overlapping or indeed conflicting, fiduciary duties proper, which are derived from general principles of private law and imposed ex post by courts in individual lawsuits.[12] As will be discussed in Section 4.2, while the structure and content of

[8] *See also* Langevoort, *supra* note 7, at 1249–50, 1252–58 (discussing the economic aspects of securities frauds in the light of the principal-agent relationship between broker and investor). *Cf.* D. Gordon Smith, *The Critical Resource Theory of Fiduciary Duty*, 55 Vand. L. Rev. 1399, 1432 (2002) (noting the applicability and limits of the principal-agent theory in relation to fiduciary relationships).

[9] *Cf.*, *e.g.*, the position of German law, *see* Section 4.3.3.

[10] *See*, characteristically, Binder, *supra* note 5 (combining both civil and common law analyses of various types of commercial and investment banking activities); *see also* Thilo Kuntz, *Das Recht der Interessenwahrungsverhältnisse und Perspektiven von Fiduciary Law in Deutschland*, *in* Festschrift für Karsten Schmidt zum 80. Geburtstag 761, 773–80 (Katharina Boele-Woelki et al. eds., 2019), for an analysis of the relevance of fiduciary duties in the areas of investment advice and corporate law.

[11] *See* Section 4.2.3.

[12] Jackson & Gillis, *supra* note 6, at 851, 853. *Cf.* Law Comm'n, *supra* note 2 (providing an early, but very comprehensive analysis of the interplay between both regimes from an English law perspective); Law Comm'n, Fiduciary Duties and Regulatory Rules (LAW COM No 236) (Dec. 1995) (same).

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regulatory regimes have been converging over the past decades, the relevant *fiduciary* principles, in terms of substance, interpretation and, indeed, their functions within the respective private law regimes, continue to vary among different jurisdictions. This is certainly true within the European Union, where EU law has gone some way to harmonize the regulatory framework, whereas the applicable private law remains defined by the laws of the Member States, many of which had established transactions-oriented principles long before the first harmonization efforts at the European level.[13]

However, in addition to the international harmonization of regulatory conduct-of-business standards, their interaction with the applicable private law regimes can also be identified as a common theme: Whether and to what extent principles of general contract law are influenced by regulatory requirements, and which of the two regimes prevails in cases of conflicting duties – such questions will ultimately influence which duties can be enforced by customers in private lawsuits against the intermediary. The answers may differ from jurisdiction to jurisdiction, depending on the doctrinal basis. Yet, the very fact that regulatory requirements and duties under general contract law coexist and that the potential for tensions between the two regimes clearly *is* a recurring phenomenon provides sufficient grounds for the hypothesis that, in the end, fiduciary activities by financial intermediaries *are* the object of an emerging transnational legal order.

Focusing on conduct-of-business standards for securities services providers,[14] this chapter explores the emergence of a transnational body of fiduciary duties of financial intermediaries. Section 4.2 examines the interaction between regulatory requirements and fiduciary principles and explains the transnational character of the former. Section 4.3 then looks into the process of how transnational regulatory principles have been adapted by European legislation, which in turn has triggered a process of convergence also of the underlying contract law regimes. In this process, substantive and organizational duties of care and loyalty have changed their nature: Principles derived from the common law doctrine of fiduciary law are adapted to different contract law regimes, while retaining their functions and meaning for the individual customer. As demonstrated by ongoing disputes concerning the relevance of regulatory duties for individual contractual relationships in several European jurisdictions, this process is by no means frictionless – but it is, for that very reason, an interesting case study in the emergence of a transnational legal order. Section 4.4 concludes.

[13] *See* Section 4.3.3.

[14] To be sure, similar observations can be made also in other areas of financial intermediation. Arguably, though, securities intermediation is a particularly well-placed object of study for present purposes, given the high degree of convergence of applicable conduct-of-business standards in this regard, especially by comparison with retail banking activities the regulation of which, at least in the EU, has not attracted the attention of the legislator to a similar extent.

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4.2 FIDUCIARY LAW IN FINANCIAL INTERMEDIATION: A TRANSNATIONAL LEGAL ORDER?!

4.2.1 *Conduct-of-Business Standards as Transnational Law: Origins, Nature, and Legitimacy*

The modern development of converging conduct-of-business standards for the provision of financial services (and, thus, toward standards for the *regulatory* treatment of relationships that qualify as "fiduciary" within the meaning defined before) can be traced back (at least) to the late 1980s and early 1990s.[15] Following preparatory work, in particular, by the French Commission des Opérations de Bourse (COB), which had published a report of self-regulatory principles for the provision of securities services in 1988,[16] the International Organization of Securities Commissions (IOSCO) promulgated a set of genuinely international, rather high-level and basic conduct-of-business standards, entitled "International Conduct of Business Principles,"[17] in July 1990.[18] With this "soft law" document, IOSCO made a first step toward the global recognition of conduct-of-business regulation as an integral part of securities regulation generally, implemented and enforced in the interest of customer protection and market integrity and distinct from market conduct regulation (e.g., regulation relating to insider trading and market abuse), on the one hand, and the prudential regulation of intermediaries' capital and liquidity positions, on the other hand.[19] The report justified the need for global convergence of such standards against the backdrop of the internationalization of securities markets since the 1970s, driven by technological progress but also the institutionalization of portfolio management in the widest sense, whereby not just issuers' and intermediaries', but also investors' activities extended increasingly beyond national boundaries.[20] Significantly, in this context, the report argued that global

[15] It is, therefore, imprecise to attribute IOSCO's work only to a later stage of international standard-setting in financial regulation, but *see* Eric Helleiner, *Regulating the Regulators: The Emergence and Limits of the Transnational Financial Legal Order*, *in* TRANSNATIONAL LEGAL ORDERS 231, 238 (Terence C. Halliday & Gregory Shaffer eds., 2015) (referring to later work products).

[16] *Cf.* Comm'n des opérations de bourse, *Rapport général du Groupe de Déontologie des Activités Financières*, BULL. MENSUEL DE LA COMMISSION DES OPÉRATIONS DE BOURSE, mars 1988, at Supplément.

[17] TECH. COMM. OF THE INT'L ORG. OF SEC. COMM'NS, INTERNATIONAL CONDUCT OF BUSINESS PRINCIPLES (July 9, 1990), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD8.pdf.

[18] *Cf., e.g.*, DIRK HERMANN BLIESENER, AUFSICHTSRECHTLICHE VERHALTENSPFLICHTEN BEIM WERTPAPIERHANDEL 205–06 (1998) (discussing the developments leading toward this report).

[19] TECH. COMM. OF THE INT'L ORG. OF SEC. COMM'NS, *supra* note 17, ¶¶ 18–21.

[20] *Id.* ¶¶ 4–7.

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harmonization of conduct-of-business standards was in the interest of market participants themselves, as universally applicable common principles

> should facilitate cross border business, encouraging competition among firms, with increased customer choice and lower costs. Commonly agreed principles should also enhance investor understanding, and hence confidence, and so increase investor participation in international markets.[21]

Conduct-of-business principles, in the report, were defined

> as those principles of conduct which govern the activities of those who provide financial services and which have the objective of protecting the interests of their customers and the integrity of the markets.[22]

To that end, the "Principles" established, in particular, the following duties of an investment firm:

- to "act honestly and fairly in the best interest of its customers and the integrity of the market" (which expressly included "any obligation to avoid misleading and deceptive acts or representations");
- to "act with due skill, care and diligence in the best interest of its customers and the integrity of the market" (which expressly included "any duty of best execution");
- to provide for and effectively employ the necessary resources;
- to "seek from its customers information about their financial situation, investment experience and investment objectives relevant to the services to be provided" (to "know one's customer");
- to "make adequate disclosure of relevant material information in its dealings with its customers" (in order to provide the customer with all relevant information needed to make informed investment decisions and in order to keep her informed as to the execution of orders); and
- to "try to avoid conflicts of interest, and when they cannot be avoided, [to] ensure that its customers are fairly treated."[23]

These principles were later taken up, and refined further, by the IOSCO "Objectives and Principles of Securities Regulation," first promulgated in September 1998,[24] the last comprehensive update of which was published in 2003.[25]

[21] *Id.* ¶ 12.

[22] *Id.* at 7.

[23] *Id.* at 8–9.

[24] Int'l Org. of Sec. Comm'ns, Objectives and Principles of Securities Regulation 33–41 (Sept. 1998), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf.

[25] Int'l Org. of Sec. Comm'ns, Objectives and Principles of Securities Regulation 32–39 (May 2003), https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf.

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To be sure, conduct-of-business standards as part of *regulatory* (as distinct from contract law) frameworks for the provision of investment services are considerably older than these international standards. Within the United States, they were first introduced by federal securities legislation in the 1930s and 1940s, most notably the Securities Exchange Act of 1934[26] and the Investment Advisers Act of 1940,[27] which, in conjunction with SEC Rules adopted under the Securities Exchange Act, prescribed transaction-oriented standards for the provision of investment services (in a wide, nontechnical sense).[28]

Given not just the global importance of the City of London, but also – at the time – the United Kingdom's considerable influence on the content of European legislation, the comprehensive reform of the regulatory framework for financial services undertaken by the British legislature in the 1980s can be identified as yet another important milestone in the process of global convergence of such standards. Replacing the former, exclusively self-regulatory arrangements with an integrated system of self-regulatory bodies and oversight by a public authority, Part I, Chapter V of UK Financial Services Act of 1986 established the statutory basis for a complex set of conduct-of-business requirements that had to be developed by the Financial Services Authority (formerly, the "Securities and Investments Board") and a number of recognized (sector-specific) self-regulatory organizations (SROs).[29]

Within the European Economic Community (as it then was), article 11 of the Investment Services Directive (ISD) of 1993[30] first established an obligation for Member States to introduce a range of harmonized, yet rather broadly defined conduct-of-business standards for the provision of investment and related services. Significantly, the requirements, to a large extent, were a *verbatim* adaptation of the 1990 IOSCO "Principles," reflecting not just the latter's usefulness as a technical source of inspiration for legislators worldwide, but also their relevance as a driving force for the trend toward global convergence. The requirements were later taken up, and refined further, by the successors to the 1993 ISD, namely the (first) markets in Financial Instruments Directive (MiFID) of 2004[31] and the current regime, laid down in articles 24 and 25 of MiFID II.[32]

[26] 15 U.S.C.A. §§ 78a et seq. (Westlaw through Pub. L. No. 117-167).

[27] *Supra* note 4.

[28] *See generally, e.g.*, HAZEN, *supra* note 7, at 18–21, for a useful introduction to these statutes and their historic background. *Cf. id.* at 632–47 (*generally* discussing of the interplay between regulatory conduct-of-business standards and fiduciary law in the United States); 2 LOUIS LOSS ET AL., FUNDAMENTALS OF SECURITIES REGULATION 1608–25 (7th ed. 2018).

[29] *See*, in particular, Financial Services Act 1986, c. 60, § 48 (authorizing the promulgation of conduct-of-business rules by the FSA); *see also id.* § 119(1)(a) (regarding the SROs' powers to promulgate separate standards of conduct).

[30] Council Directive 93/22/EEC, art. 11, 1993 O.J. (L 141) 27, 37.

[31] European Parliament and Council Directive 2004/39/EC, arts. 18, 19, 2004 O.J. (L 145) 1, 16–18.

[32] MiFID II, *supra* note 3.

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Against this backdrop, the publication of the first version of the IOSCO Principles, in 1990s, clearly was not the trigger of global convergence, but merely a reflection of a growing convergence among national authorities that had started sometime before. For three reasons, however, the significance of the "Principles" goes far beyond a mere formal recognition of that trend and helps explain the successful emergence of genuinely transnational standards in the field.

First, the Principles' origins in an institutionalized cooperation of securities authorities clearly distinguishes them from other initiatives for the global harmonization of laws, as they do not just reflect the perspective of an impressive range of important jurisdictions, but also reflect these jurisdictions' willingness to coordinate their respective laws and enforcement regimes accordingly. Originating from the Inter-American Conference of Securities Commissioners (established in 1974), IOSCO had been created as a global institution with an impressively broad membership base in the mid-1980s.[33] By instituting an international "working group on Principles of ethical conduct," with members from Hong Kong, Italy, Japan, Quebec, Sweden, Switzerland, the United Kingdom, Germany, as well as the Securities and Exchange Commission and the Commodity Futures Trading Commission of the United States, with Australia as a correspondent member,[34] IOSCO's Technical Committee had, in fact, brought together authorities from the most important financial markets worldwide. While in itself the result of technocratic regulation without participation of democratically elected political actors, this background undoubtedly helped enhance the legitimacy of the Principles in the eyes of legislators of participating jurisdictions, inasmuch as they could be interpreted as reflecting the accumulated expertise of leading authorities in the field of securities regulation. In this respect, the IOSCO standards fall in line with the development of international standard-setting in the area of financial regulation more generally (sometimes referred to as "The Global Financial System"), which was first associated mainly with the activities of the Basel Committee on Banking Supervision in the 1970s and was reinforced through various policy initiatives by the G-20 nations under the auspices of the newly created Financial Stability Board after the global financial crisis.[35] To be sure, IOSCO's influence on global legislative developments has been limited so far, especially by comparison with the output generated by the Basel Committee and its impact on the convergence of regulatory frameworks in the field of prudential banking regulation.[36] Although national

[33] *See, e.g.*, Emilios Avgouleas, Governance of Global Financial Markets: The Law, the Economics, the Politics 173–74 (2012).

[34] Tech. Comm. of the Int'l Org. of Sec. Comm'ns, *supra* note 17, ¶ 2.

[35] *See, e.g.*, Chris Brummer, Soft Law and the Global Financial System 70–90 (2012) (*generally* discussing the different standard-setting bodies); Helleiner, *supra* note 15, at 232–49 (same). *See also* Ross P. Buckley & Douglas Arner, From Crisis to Crisis: The Global Financial System and Regulatory Failure (2011), for an analysis of the crisis-driven history of the relevant institutional arrangements.

[36] Brummer, *supra* note 35, at 78.

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interpretations of the standards and enforcement practices continue to differ considerably between individual jurisdictions at a more granular level,[37] the relevance of IOSCO's work on conduct-of-business standards is hardly disputable, precisely because the "Principles" reflected (and reinforced) earlier trends toward global convergence, which were then taken up also in incoming European legislation.

Second, and relatedly, the interplay between international standards with incoming EU regulation certainly played an important role as a driving force toward global convergence. Because the IOSCO Principles, as noted before, were formative for the development of harmonized conduct-of-business standards under the European Investment Services Directive of 1993[38] and, subsequently, MiFID I and MiFID II,[39] their importance as a global benchmark was reinforced. At the same time, the representation of European jurisdictions in the working group arguably was instrumental to shape the Principles' character as a product of genuinely transnational collaboration between legal systems of different origins. Motivated by the objective to create a common Internal Market for financial services among the Member States of the European Economic Community and, subsequently, the European Community and the European Union,[40] European legislation and European institutions thus contributed to, and reinforced, a more general trend toward global convergence of financial law and regulation and established themselves as an important driving force toward the globalization of markets and relevant legal frameworks. At the same time, the rise of European financial markets began to balance out the dominance of US law and regulation as the dominant rule-maker for global transactions. In this respect, the development of transnational conduct-of-business standards for the fiduciary relationship between financial intermediaries and their customers mirrored a broader trend in international financial regulation, which can be observed particularly clearly in the field of banking regulation.[41]

Third, by taking the form of an easily accessible, concise, indeed rather simple document, the standards certainly were highly conducive to application across a wide variety of different jurisdictions. As formulated in the IOSCO Principles, the

[37] *Cf.*, *e.g.*, Howell E. Jackson, *Variation in the Intensity of Financial Regulation: Preliminary Evidence and Potential Implications*, 24 Yale J. on Reg. 253 (2007) (providing an illustrative trans-Atlantic analysis); Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-Based Evidence*, 93 J. Fin. Econ. 207 (2009) (same).

[38] *Supra* note 31.

[39] *Supra* notes 32 and 3, respectively.

[40] *See* Section 4.3.1, for a discussion of the relevant policy and legal background.

[41] *Cf.* Brummer, *supra* note 35, at 45–48 (discussing the impact of European financial lawmaking on global financial governance). *Cf. also* Kern Alexander et al., Global Governance of Financial Systems: The International Regulation of Systemic Risk 174–83 (2006), for a general analysis of the emergence of global "soft law" in financial regulation.

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conduct-of-business standards do not even purport to provide a comprehensive legal framework for the formation and execution of contracts between intermediaries and their customers, or, indeed, for specific means of enforcement of duties arising thereunder. With a focus on individual aspects of the intermediary-customer relationship, they merely establish minimum qualitative standards addressing agency problems in general, and conflicts of interests and information asymmetries in particular, between the two parties – standards that can (and, indeed, are designed to) be implemented and enforced differently in different legal and institutional environments. This approach was clearly motivated by residual differences among IOSCO member states in terms of both substantive law and enforcement mechanisms.[42]

Importantly, this background reflects a need to redefine what is actually meant by "fiduciary law" in a transnational context. Despite obvious parallels and similarities between the regulatory standards and traditional concepts of the common law of fiduciary relationships,[43] transnational conduct-of-business standards pertaining to the fiduciary relationship between financial intermediaries and their customers are generic in the sense that they can, and will, apply irrespective of whether or not the legal environment is constituted by common law principles. As illustrated by the IOSCO Principles, transnational law governing fiduciary relationships in the field of financial intermediation, in order to be adaptable across different jurisdictions with different systems of private law, inevitably has to be defined exclusively by its object and objectives rather than by reference to the doctrinal roots of fiduciary law in common law legal systems. The quest, in other words, has been for universally acceptable solutions to common problems deriving from the *status* of the relevant parties to contractual relationships (which, in a common law environment or in law and economics terminology influenced by concepts of common law, can be characterized as "agency" or "fiduciary" relationships). In order to be adaptable, the relevant standards therefore had to establish "functional" (as distinct from doctrinal-technical) fiduciary law. By contrast, a mere "transplantation" of common law fiduciary law into other legal environments – that is, the application of the same set of substantive rules without regard to the specific nature of the applicable contract law regime – would inevitably create coordination problems between conflicting regimes.[44]

[42] *Cf.* Tech. Comm. of the Int'l Org. of Sec. Comm'ns, *supra* note 17, ¶ 25: "Conduct of business rules are implemented by the different member organisations in a variety of ways: laws; regulations; internal rules within a company or institution; unwritten principles and customs; case law."

[43] *See* Section 4.2.

[44] In this regard, the ongoing discussion on the legal nature of regulatory conduct-of-business rules and their implications on contractual duties of intermediaries in a number of European jurisdictions can be interpreted as ample evidence, *see* Section 4.3.3.

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4.2.2 *From Fiduciary Law to "Functional Fiduciary Law": The Fiduciary Roots of Conduct-of-Business Regulation (and Some Implications on the Relevance of Regulatory Fiduciary Duties for the Intermediary-Customer Relationship)*

If, as discussed before, converging conduct-of-business standards in the field of securities intermediation can be interpreted as the establishment of transnational fiduciary law in the field of financial intermediation, this finding, as such, tells us little about the functions of the relevant rules within the broader legal framework that governs the rights and duties of parties to relevant contracts, especially vis-à-vis the applicable contract law regime. This caveat should not come as a surprise: Precisely because the relevant standards address only selected, if crucial aspects of the intermediary-customer relationship, and because they do so at a rather abstract level, their technical relevance (and doctrinal interpretation) is bound to differ depending on the nature and content of the relevant contract law environment.

In order to facilitate the understanding of the core characteristics of transnational fiduciary law in the field of financial intermediation in substantive as well as in functional terms, however, the analysis clearly cannot stop here. In this context, it is particularly important to note that conduct-of-business regulation for financial services has never – and nowhere – been developed, or applied, independently from principles or doctrines of general private law, originating outside the regulatory sphere. Rather, such standards can be said to have *complemented* general principles of contract or, indeed, fiduciary (or agency) law: Both from a historic perspective and in terms of substantive content, they were developed in order to enhance the protection of investors against intermediaries. As a result, investors were protected as the beneficiaries of agency relationships in a wider sense, who otherwise could rely only on general principles of contract, tort, agency, or, again, fiduciary law.[45] Historically, the emergence of conduct-of-business standards in US securities regulation certainly was revolutionary less in terms of the substantive content (which, in many respects, can be traced back to general principles of common law), but rather in terms of the transformation of such principles into mandatory requirements, to be operationalized in each securities firm's operations and business practices and to be monitored by public authorities ex ante. In other words, it is hardly surprising that the gradual recognition of duties of care, knowledge, and skill in the applicable *regulatory* frameworks, to some extent at least, mirrored preexisting *general* principles of law, including core principles of the common law of fiduciary duties. Nor should it come as a surprise that regulatory rules may come to be interpreted, and

[45] *Cf.*, for a forceful statement to that effect, SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, at 191 (1963) (noting that: "The Investment Advisers Act of 1940 … reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship. …'")

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applied, by recourse to general principles of law (including, again, principles of fiduciary law) – and may even influence the interpretation and further development of such general principles in ex post litigation. Historically, the interplay between regulatory and legal conduct-of-business standards in US law provides ample evidence of this development of regulatory rules by reference to general norms of fiduciary law. In the United States, both regulatory agencies (in particular, the Securities Exchange Commission) and courts, respectively, have repeatedly (a) reinforced existing regulatory norms by adapting fiduciary principles in the course of their interpretation in specific circumstances, (b) transformed fiduciary principles into new regulatory requirements, or (c) "filled the gaps" left by regulatory requirements through imposing additional restrictions on intermediaries based on general principles of fiduciary law.[46]

Against this backdrop, it is also not surprising that the IOSCO Principles' restatement of conduct-of-business requirements in some ways paralleled traditional common law fiduciary norms. The Principles focused on establishing "functional fiduciary law" – that is, a duty of care and skill in the interest of customers and on preventing or, at least, mitigating potential conflicts of interests on the part of the intermediary and their implications for the customers. Of course, one should not press the point too far. Differences between traditional concepts of fiduciary law on the one hand and the individual conduct-of-business standards on the other hand certainly exist, and the regulatory standard often deviates substantially from generally accepted principles of fiduciary law.[47] Nonetheless, the parallels are particularly obvious with regard to the fiduciary duty to avoid conflicts of interests, the fiduciary's duty not to exploit his position at the expense of the beneficiary, and the duty of loyalty to the beneficiary.[48]

It follows that regulatory requirements and private law, including fiduciary principles, pertaining to the same activities – different types of financial services – cannot and should not be conceptualized as functionally separate regimes. Rather, they are functional complements, designed to work together to ensure adequate levels of investor protection. Conduct-of-business regulation and parallel principles of private law thus illustrate the more general observation that the purposes of modern private law, almost inevitably, are not confined to defining the rules for private contracting in full freedom ("private autonomy" in a civil law perspective), but usually include

[46] *See* Jackson & Gillis, *supra* note 6, at 868–69 (discussing specific examples). *Cf.* Hazen, *supra* note 7, 632–39; Loss et al., *supra* note 28, 1608–25. And *cf.* Law Comm'n, *supra* note 2, at Part VI, for a useful analysis of the policy choices encountered when structuring the interplay between regulatory and private law requirements from an English law perspective.

[47] One – important – example is the regulatory requirement to treat customers fairly, which does not appear to have origins in English case law; *cf.* Joanna Benjamin, Financial Law, ¶¶ 27.11, 27.21–27.25 (2007).

[48] *Cf.* Law Comm'n, *supra* note 2, ¶ 2.4.9, for a useful summary of the core elements of fiduciary duties in the present context.

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(semi-)regulatory objectives to ensure fairness between unequal parties.[49] Fiduciary law, with its focus on the protection of "vital interactions of high trust and confidence resulting in one party's implicit dependency upon and peculiar vulnerability to another" certainly has a regulatory element to the extent that it imposes "strict duties requiring fiduciaries to act honestly, selflessly, with integrity, and in the best interests of their beneficiaries."[50]

Thus, conduct-of-business regulation facilitates additional enforcement and sanctions mechanisms to duties at least some of which, in substance, existed previously in fiduciary law or elsewhere in general private law. These regulations recognize and address agency problems between intermediaries and their customers, particularly structural information asymmetries and conflicts of interests inherent in the business model of financial intermediaries and the resulting incentives for the expropriation of customers by intermediaries. Of course, within the EU as well as elsewhere, *regulatory* standards apply in their own right and irrespective of the applicable private law. In view of existing regulatory enforcement powers, it may therefore appear pointless to discuss their private law implications.[51] However, private law – and private enforcement – matter for the effectiveness of *regulatory* norms from a customer perspective. After all, public authorities' enforcement of norms will be limited, not just due to limited resources, but possibly also to the incentive structures of public officials.[52] Private law may replicate the substance of regulatory norms in some cases. And where private law does not do so, the effectiveness of regulatory norms crucially depends on whether or not private enforcement of the regulatory norms is possible.

The aforementioned analysis should not be misinterpreted as suggesting that regulatory requirements, as enforced by public authorities ex ante, and general principles of law, as enforced by courts in private lawsuits ex post, are functionally identical sides of the same coin. They are, in fact, not just operationalized in

[49] *Cf.* Hanoch Dagan & Avihay Dorfman, *Just Relationships*, 116 Colum. L. Rev. 1395 (2016), for a recent general discussion. And *see* Alexander Hellgardt, Regulierung und Privatrecht (2016), for an impressive analysis of the regulatory functions of private law.

[50] In the words of Leonard I. Rotman, Fiduciary Law 250, 255 (2005); Rotman, *supra* note 1, at 986.

[51] *See*, to that effect, Luca Enriquez & Matteo Gargantini, *The Overarching Duty to Act in the Best Interest of the Client in MiFID II, in* Regulation of the EU Financial Markets: MiFID II and MiFIR ¶ 4.01, ¶ 4.16 (Danny Busch & Guido Ferrarini eds., 2017) (discussing the nature of EU conduct-of-business standards).

[52] On the respective advantages and shortcomings of public and private law enforcement, *see generally*, *e.g.*, Richard A. Posner, Economic Analysis of Law, at ch. 24 (9th ed. 2014); Mitchell A. Polinsky & Steven Shavell, *The Economic Theory of Public Enforcement of Law*, 38 J. Econ. Lit. 45 (2000); Mitchell A. Polinsky & Steven Shavell, *The Theory of Public Enforcement of Law*, *in* Handbook of Law and Economics 403 (Mitchell A. Polinsky & Steven Shavell eds., 2007).

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different ways, but may also serve partly different objectives.[53] Nor should it be forgotten that the substantive content of the two regimes may differ and, indeed, conflict.[54] At the same time, though, it is important to recall that even in the United States, as the country of origin of modern conduct-of-business regulation, where relevant principles had been developed long before the trend toward global convergence of securities laws in the 1980s and 1990s arose, the regulation of the intermediary-customer relationship has transcended traditional concepts of fiduciary law from the very origins of modern securities regulation in the 1930s and 1940s. The emergence of what we could describe as "functional fiduciary law," a set of rules and requirements addressing the specific agency problems of the relationship between intermediaries and investors, thus took place long before the relevant substantive rules became exported to, and adapted by, foreign jurisdictions in the course of the globalization of securities regulation at a later stage. As a consequence, the analysis of fiduciary principles in the area of financial intermediation inevitably has to rely on a nontechnical, "functional" understanding of fiduciary principles – an understanding that is determined by the protective objectives of fiduciary law[55] rather than by its traditional emanation in common law.

Similar considerations apply with regard to the resulting tensions between regulatory standards and private law – and thus the need to determine whether and to what extent the applicable *regulatory* standards should have a bearing on the individually enforceable *private law* duties arising within intermediary-customer relationship (whether these follow from general contract law or, for that matter, other general principles of law, including tort, agency, or indeed fiduciary law in the technical sense).

Problems of coordination inevitably arise. Regulatory standards and private law duties will in some cases differ from and, potentially, conflict with each other. The need to reconcile *regulatory* duties – "functional fiduciary law" within the meaning defined previously – with each jurisdiction's *private* law environment therefore has to be considered as part and parcel of the emerging body of transnational fiduciary law in the area of financial services regulation. In a transnational context, defining a solution to these problems of coordination will be particularly difficult precisely because the operation of "functional fiduciary law" or, at least, its impact on the intermediaries' privately enforceable duties vis-à-vis their customers, is inevitably contingent on how each individual jurisdiction will coordinate *regulatory* duties on

[53] Note, in this context, that the IOSCO "Principles," in addition to the protection of investors, are also designed so as to protect market integrity, which certainly does not form part of intermediaries' duties to customers under general contract or, indeed, fiduciary law. TECH. COMM. OF THE INT'L ORG. OF SEC. COMM'NS, *supra* note 17, at 7–9.

[54] *See supra* note 48 and accompanying text. *Cf.* Jackson and Gillis, *supra* note 6, for a functional analysis of overlaps and tensions between fiduciary law and regulation in the United States. *Cf. also* LAW COMM'N, *supra* note 2, at Part VI, for a similar analysis from an English law perspective.

[55] As to which, *see*, again *supra* text accompanying note 50.

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the one hand and the applicable *private law* on the other hand. One could characterize this problem as the fundamental "contingency problem" for the development of transnational fiduciary law in the field of financial services: the problem that a truly transnational understanding of what constitutes fiduciary obligations of financial intermediaries toward their customers and how these obligations affect the customers' position in their individual contractual relationships is contingent on the interplay between regulatory rules and the applicable private law.

Given the long-standing trend toward international cooperation between supervisory authorities and convergence of regulatory standards as well as supervisory practices in all fields of financial regulation and supervision, there is no reason to doubt that the implementation and supervisory enforcement of regulatory conduct-of-business standards, as such, can be accomplished effectively and consistently. The convergence of applicable standards, developed within the institutional framework of IOSCO, provides ample evidence in this regard. The "contingency problem" identified earlier, by contrast, is inevitably more difficult to resolve – and it clearly presents a rather complex impediment for the development of transnational fiduciary law in the field. The case of conduct-of-business regulation in the European legislative framework, to be considered in Section 4.3, illustrates the point.

4.3 MAKING TRANSNATIONAL LAW APPLY TRANSNATIONALLY: THE CASE OF EUROPEAN FINANCIAL LAW

4.3.1 *European Financial Law and Conduct-of-Business Regulation: A Primer*

With far-reaching powers to enact legislation designed to harmonize national laws or, indeed, to create universal rules for application across no less than twenty-eight (post-Brexit: 27) jurisdictions with different legal traditions, substantive laws, and enforcement institutions, the European Union[56] indisputably is an important driver toward convergence in all areas of law and regulation covered by the mandate (and corresponding powers) laid down in the Treaty on European Union (TEU) and, in particular, the Treaty on the Functioning of the European Union (TFEU). It is an open question whether or not (and, if so, to what extent and subject to which qualifications) European financial law would qualify as a "transnational legal order." To be sure, EU law generally constitutes a legal order, and a highly developed one for that matter, considering the specific constitutionalization of the European Union (not quite a federation of states, but certainly more than an international organization), the comprehensive perimeter of European economic lawmaking as a whole (which covers legislation in all areas of economic activity), the

[56] The same already applied to its predecessors, namely the European Economic Community and the European Community.

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existence of European (as distinct from national) regulatory and supervisory agencies, and the corresponding high level of harmonization of national laws and regulations.[57] Taken together, though, these aspects certainly distinguish European financial law from other areas of international cooperation of legislators, authorities and/or courts in different jurisdictions.[58] More specifically, it could be argued that, owing to the high level of integration of national jurisdictions the EU Member States, EU lawmaking, even though it formally involves a multitude of jurisdictions, is structurally closer to coordination problems within a *single* jurisdiction and thus lacks the characteristics of genuine transnational legal ordering. In this context, it is worth noting that, under the European Treaties, compliance with, and implementation of, legal rules adopted at the European level takes place within a pre-defined legal framework, in which Member States are bound to give effect to EU legislation, and judicial powers to resolve any controversy as to its legality and substantive content are allocated to the European Court of Justice, which issues decisions that are binding on the Member States.[59]

It is neither possible nor necessary to fully explore the nature of EU financial law within this chapter. It is important here to stress two points. First, European financial law and the relevant institutional arrangements established within the EU may have to be qualified for the purposes of transnational law theory. Second, however, it is certainly true that the EU and its institutions have played an important role not just in *shaping* the "transnational financial legal order"[60] established at a *global* level, but also in terms of *implementing* the work promulgated by international standard-setters. In the field of securities regulation, as in financial regulation more generally, European legislation has thus been instrumental to turn international "soft law" standards promulgated by international standard-setting bodies (such as IOSCO) into "hard law," be it in the form of Directives (which harmonize the national laws of the Member States) or of Regulations (which apply directly and universally in all Member States).[61] Both as an increasingly powerful negotiating party in working groups responsible for the development and the reform of regulatory standards and in view of its powers to render such standards effective across a large and important market, the EU has contributed to the effectiveness and success of that legal order,

[57] *Cf.* Terence C. Halliday & Gregory Shaffer, *Transnational Legal Orders*, *in* Halliday & Shaffer, *supra* note 15, at 3, 5. (suggesting the following definition of a transnational legal: "a collection of formalized legal norms and associated organizations and actors that authoritatively order the understanding and practice across national jurisdictions.")

[58] *Cf. id.* at 18–21, for a general discussion of what constitutes the relevant "transnational" element.

[59] *See* Consolidated Version of the Treaty on the Functioning of the European Union art. 267, July 6, 2016, 2016 O.J. (C 202) 1 [hereinafter TFEU] (setting out the procedure and status of adjudicating on "preliminary reference" by national courts); *see generally*, *e.g.*, Damian Chalmers et al., European Union Law 166–88 (4th ed. 2019).

[60] To borrow the term coined by Helleiner, *supra* note 15.

[61] On the differences and relevance of Directives and Regulations (as defined by TFEU art. 288 (2) and (3)), *see generally* Chalmers et al., *supra* note 59, at 114.

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making it a useful object of study for present purposes irrespective of whether European law itself qualifies as a transnational legal order in its own right or merely as a (partly autonomous) subset of a larger system.

Moreover, EU legislation in the field of financial services regulation, irrespective of the constitutional environment and its embeddedness in an institutional structure defined in the Treaties, arguably is also a showcase for more general problems of coordination between different legislators, authorities, and courts, problems pertaining to the national "operationalization" of legal rules and norms originating at a supranational level. The ongoing controversy about the need for private law implications of regulatory conduct-of-business standards established by EU law[62] is a particularly illustrative case in point. These problems, which – as noted before – inevitably come with implications for the effectiveness of *any* attempt to apply solutions developed at a supranational level to circumstances within a national turf, are likely to be more or less identical with those observable in the context of transnational legal orders proper.[63] Irrespective of the idiosyncratic characteristics of EU financial law and regulation (and EU economic lawmaking more generally), an analysis of the conditions for and the functioning of the harmonization of conduct-of-business standards for financial intermediaries established in EU law can thus be expected to contribute to our understanding of transnational legal orders more generally. Much the same applies with regard to the interplay between the different levels of rule-makers and standard-setters, and its implications on the interpretation and implementation of both legal rules and principles of supranational origin in the national legal environments, respectively.[64]

Against this backdrop, it should be recalled that conduct-of-business regulation has been a core element of EU financial law ever since the introduction of harmonized principles for the regulation of investment services with the Investment Services Directive of 1993. The relevant legal acts – the Investment Services Directive, MiFID I and MiFID II[65] – were all enacted on the basis of Treaty provisions mandating the adoption of directives for the harmonization of national conditions for market entry by individual providers of goods or services or for companies from other EU Member States.[66] Significantly, the relevant provision

[62] *See* Section 4.3.3.

[63] *See generally* Halliday & Shaffer, *supra* note 57, at 31–55 (discussing general aspects of the formation and institutionalization of transnational legal orders).

[64] *Cf. id.* at 55–63 (discussing various scenarios of how transnational legal orders trigger similar impacts).

[65] *See supra* notes 31, 32 and 33.

[66] *See* TFEU art. 53(1). ("In order to make it easier for persons to take up and pursue activities as self-employed persons, the European Parliament and the Council shall . . . issue directives for the mutual recognition of diplomas, certificates and other evidence of formal qualifications and for the coordination of the provisions laid down by law, regulation or administrative action in Member States concerning the taking-up and pursuit of activities as self-employed persons.")

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(just as its predecessors in earlier Treaties)[67] is confined to the removal of differences in the conditions for market participation in order to facilitate the creation of an integrated "Internal Market" for goods and services, historically the core policy objective of the European Union (*cf.* art. 3(3) TEU), which requires a regulatory "level playing field" and, thus, harmonized rules governing the provision of financial services across all Member States.[68] Just as with other aspects of EU financial regulation, the harmonization of conduct-of-business standards for investment firms, which (at least initially) accomplished the liberalization of national regulations, served as an instrument to facilitate the mutual access of financial intermediaries licensed in one of the Member States to what used to be reclusive domestic markets.[69] Given that this clearly served the interests of the regulated industry, it is fair to note close parallels between the development of European financial regulation on the one hand and the driving forces behind the emergence of *global* ("transnational") conduct-of-business standards identified earlier:[70] At both levels, the standards were driven by the desire to provide a mutually acceptable basis for market access and market integration, and at both levels, this motive may have helped to enhance the industry's readiness to adapt and comply.

While allowing for a comprehensive harmonization of the regulatory frameworks (not just) for securities intermediaries, however, this constitutional background also accounts for an important limitation to the role of EU legislation as a catalyst for convergence in the conditions for the provision of such services across the Member States. Because the focus was on the harmonization of conditions for market access, EU financial law has never aimed at a full harmonization of all norms of relevance for the contractual relationship between intermediaries and customers – an attempt that would not just have been technically difficult (given residual differences in the national private laws of the Member States) and fraught with political controversies. Arguably, it also would have exceeded the scope of the relevant legislative powers, which (at least expressly) do not provide for a comprehensive harmonization of general private law, even when confined to individual areas of particular relevance to the Internal Market.[71]

[67] TFEU art. 53(1) effectively replicates the wording of art. 47(2) of the former Treaty on the European Community, which itself was based on art. 57(2) of the Treaty on the European Economic Community.

[68] For a general discussion of the constitutional basis for EU securities regulation, *cf.* Niamh Moloney, EU Securities and Financial Markets Regulation 8–13 (3d ed. 2014).

[69] *See id.* at 19–22; *see also* Jens-Hinrich Binder, *Vom offenen zum regulierten Markt: Finanzintermediation, EU-Wirtschaftsverfassung und der Individualschutz der Kapitalanbieter*, 25 Zeitschrift für Europäisches Privatrecht [ZEuP] 569 (2017), for a detailed analysis of the parallels between EU banking and securities regulation in this regard.

[70] *See supra* note 21 and accompanying text.

[71] For a more in-depth discussion, *see* Binder, *supra* note 69, at 588–89, 592–93 and 596–98. And for an early assessment of the limitations for (and the rationale of) the harmonization of conduct-of-business standards through the Investment Services Directive of 1993, *cf.* Johannes

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To be sure, as will be explored in Section 4.3.2, significant aspects of the European conduct-of-business standards (just as the original IOSCO Principles of 1990) bear close similarities with traditional concepts of fiduciary relationships recognized by common law. Given the restrictions of their legal basis in European Treaty law, the relevant provisions, nonetheless, must not be misinterpreted as mandating the introduction of fiduciary duties in a technical sense, that matter being outside the scope of the relevant instruments and left to the discretion of the Member States.[72] Just as the IOSCO Principles, the relevant standards therefore can be characterized as "functional fiduciary law" within the meaning defined previously. While the regulatory standards clearly address core problems of the principal-agent relationship between intermediaries and clients and apply to relationships that would qualify as fiduciary in common law, the interplay between these standards and the applicable private law environment of the Member States is not specified in detail by European law. Whether or not at least some form of private law implications, for example, in the form of contractual, damages for violations of regulatory obligations still ought to be recognized as a matter of European law, remains an open question.[73]

4.3.2 *What Has Become of the IOSCO "Principles": Conduct-of-Business Regulation in Current EU Legislation*

While a detailed analysis of the current version of conduct-of-business requirements for investment firms in European law, laid down in articles 24 and 25 of MiFID II (as well as in delegated legal instruments adopted by the European Commission in connection with these provisions),[74] would be outside the scope of this chapter,[75] the close parallels between the substantive content of relevant duties and the early precedents in the IOSCO Principles of 1990 are nonetheless worth noting. Although formulated in significantly more complex terms and in far greater detail, the relevant provisions take up all aspects of the original principles. As a general duty that also seeks to fill the gaps left by more specific requirements,[76] article 24(1) MiFID II first establishes a general duty of investment firms,

Köndgen, *Rules of Conduct: Further Harmonisation?*, *in* European Securities Markets: The Investment Services Directive and Beyond 115 (Guido Ferrarini ed. 1998).

72 Enriquez & Gargantini, *supra* note 51, ¶ 4.16.

73 On which, *see* further Section 4.3.3.2.

74 *See* Commission Delegated Regulation (EU) 2017/565, 2017 O.J. (L 87) 1; and Commission Delegated Directive (EU) 2017/593, 2017 O.J. (L 87) 500. Note that the relevant requirements are specified further in "Guidelines" promulgated by the European Securities and Markets Authority (ESMA) (*see* art. 25(9)–(11) MiFID II, *supra* note 3, outside the scope of the present paper).

75 *See*, for more extensive analyses, of the current regime, *e.g.*, Enriquez & Gargantini, *supra* note 51; Stefan Grundmann & Philipp Hacker, *Conflicts of Interest*, *in* Busch & Ferrarini, *supra* note 51, at ch. 7.

76 *See*, for further discussion of the functions of the duty within the MiFID II framework, Enriquez & Gargantini, *supra* note 51, ¶¶ 4.16–4.22.

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> when providing investment services or, where appropriate, ancillary services to clients, [to] act honestly, fairly and professionally in accordance with the best interests of . . . clients . . ..

Article 24(2), subpara. (2) MiFID II then requires that investment firms

> understand the financial instruments they offer or recommend, assess the compatibility of the financial instruments with the needs of the clients to whom it provides investment services, also taking account of the identified target market of end clients (. . .), and ensure that financial instruments are offered or recommended only when this is in the interest of the client.

Pursuant to article 24(3) MiFID II (specified further and complemented with detailed duties to inform and warn of risks in para. (4) of the same provision),

> [a]ll information, including marketing communications, addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading. Marketing communications shall be clearly identifiable as such.

Article 24(5) MiFID II then continues to define the format and quality of the required information, which has to

> be provided in a comprehensible form in such a manner that clients or potential clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. Member States may allow that information to be provided in a standardised format.

Article 24(8) and (9) MiFID II restrict the acceptability of commissions or other benefits by investment firms for the marketing and recommendation of financial products and thus address an important source of conflicts of interest that could impair the quality of investment advice and related services. In a similar vein, article 24(10) MiFID II prohibits incentive structures that could induce staff to offer financial products whose acquisition would not be in the client's best interest. Complementing these provisions, article 25(1) MiFID II then establishes requirements for the qualification of natural persons providing investment advice and related services, while article 25(2)-(4) MIFID II specify the obligations of investment firms to explore their clients' interest prior to the provision of services.

4.3.3 *The Functions and Enforcement of Conduct-of-Business-Regulation in Europe: A German and a European Perspective*

4.3.3.1 German Law

If the effectiveness of "functional fiduciary law" crucially depends on the interplay between *regulatory* standards and the relevant *private law*

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environment,[77] EU financial law certainly is a highly illustrative case in point. Just as in other areas of EU legislation, the introduction of harmonized conduct-of-business standards since 1993[78] had to be implemented in Member States with different legal traditions, different contract laws, and, in particular, fundamentally different legal regimes governing the relationship between financial intermediaries and their customers. Among these, only a small fraction – namely, the United Kingdom and Ireland – are common law jurisdictions, the remainder being variants of civil law legal systems. While it is, for obvious reasons, impossible to develop a full account of the relevant private law environments in each and every Member State within this chapter, it is probably safe to assume that at least in the majority of them, the relevant aspects of intermediary-client relationships (general duties of care and skill, principles governing conflicts of interests, as well as duties to inform and disclose) had already been addressed in the applicable contract law (to some extent, as the case may be, complemented by general principles of private law).[79] It should come as no surprise that the interplay between regulatory conduct-of-business standards and private law has been debated for some time in response to incoming European legislation, with only few jurisdictions having developed clear-cut solutions for the reconciliation of regulatory and private law regimes.[80]

German law illustrates the point. Building both on general contract law, which does not provide a bespoke regime addressing intermediary-client relationships, and on general principles of private law, including on misrepresentation prior to or in the course of contractual relationships, German courts, in particular in the aftermath of a landmark decision in 1993,[81] have over time defined a rather complex set of duties of care and skill with regard to the provision of investment advice, which includes both prescriptive and proscriptive elements. As established in a large body of case law,[82] investment firms are required (a) to ensure that any advice given has to be commensurate with the investor's profile and risk preference, (b) to explore their clients' expertise, financial position, and risk preference prior to the provision of

[77] *See* Section 4.2.1.

[78] On the relevant legal instruments, *see*, again, *supra* notes 31–33 and accompanying text.

[79] For a representative overview, compare the country reports on selected civil and common law jurisdictions in Busch & van Dam, *supra* note 5. *See also* Danny Busch, *Why MiFID Matters to Private Law – The Example of MiFID's Impact on Asset Managers*, 7 Cap. Markets L.J. 386 (2012).

[80] *See*, for an early assessment of the relevant problems, *e.g.*, Peter O. Mülbert, *The Eclipse of Contract Law in the Investment Firm-Client-Relationship: The Impact of the MiFID on the Law of Contract from a German Perspective*, *in* Investor Protection in Europe – Corporate Law Making, the MiFID and Beyond 299 (Guido Ferrarini & Eddy Wymeersch eds., 2006).

[81] Bundesgerichtshof [BGH] [Federal Court of Justice] July 6, 1993, 123 Entscheidungen des Bundesgerichtshofs in Zivilsachen [BGHZ] 126. *See* Binder, *supra* note 5, at 75. The following paragraphs borrow from that publication.

[82] For an in-depth account of the relevant private law environment, an analysis of the resulting duties of intermediaries, and references to case law, *see*, again, Binder, *supra* note 5, at 66–81.

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investment advice, (c) to inform their clients of all aspects that are material for their investment decisions, (d) to explore the characteristics and risk profile of any investment recommended to clients, and (e) to warn clients if, on the basis of the exploration of their individual expertise and risk profile, they perceive the client to be unaware of specific risks arising in the context of a proposed investment. Even though fiduciary law, in the common law interpretation of the concept, does not exist in German private law, the parallels between these principles and fiduciary duties in the common law understanding are obvious.

Nonetheless, the functional interplay between these principles and the regulatory requirements enacted in order to transpose the incoming European Directives (first in sections 31–34 and, since 2017, in sections 63–71 of the Wertpapierhandelsgesetz [Securities Trading Act][83]) has been debated controversially in German legal doctrine ever since the transposition of the Investment Services Directive 1993, while the courts have been reluctant to recognize any implication of the regulatory regime for the construction of the contractual relationship between intermediaries and their clients.[84] Prior to the transposition of MiFID into the German Securities Trading Act, the Federal Supreme Court did acknowledge, albeit somewhat imprecisely, that the regulatory requirements, although based in public law, could have a bearing on contractual duties to the extent that their objective was to protect the clients; even so, the Court did not construe duties of care independent from those established under general contract law.[85] In some decisions, the Federal Supreme Court and other courts have also referred to provisions of earlier versions of the WpHG as a basis for a duty to avoid adverse consequences of conflicts of interests for clients.[86] The practical consequences of this approach, however, remain obscure. In the academic literature, which is frequently cited as persuasive authority by German courts, the controversy continues about whether, and to what extent, implications of regulatory conduct-of-business standards on the private law relationships between intermediaries and customers ought to be recognized. The prevailing opinion is that regulatory conduct-of-business standards, *qua* rooted in public law, cannot be considered as authoritative for the determination of obligations arising in private law. But in recent years an increasing number of scholars have argued for reconciliation of both regimes.[87]

[83] Wertpapierhandelsgesetz [WpHG] [Securities Trading Act], July 26, 1994, BGBl I at 1749, repromulgated Sept. 9, 1998, BGBl I at 2708, as amended June 23, 2017, BGBl I at 1693.

[84] *See generally* Matthias Casper & Christian Altgen, *Germany*, *in* Liability of Asset Managers (Danny Busch & Deborah A. DeMott eds., 2012), ¶ 4.01, ¶¶ 4.37–4.41.

[85] *Cf.*, *e.g.*, BGH, Dec. 19, 2006, 170 BGHZ 226 (232); BGH, July 24, 2011, 17 Neue Juristische Wochenschrift-Rechtsprechungs-Report [NJW-RR] 405 (406), 2002.

[86] *Cf.*, *e.g.*, 170 BGHZ 226 (234).

[87] *Cf.* Binder, *supra* note 5, at 72–74 (summarizing the case law and the relevant academic literature).

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Given residual differences between the two regimes, this state of affairs is clearly unsatisfactory, and strong arguments have been advanced supporting a further realignment between the two regimes. Nonetheless, German law as it currently stands continues to interpret both regimes as functionally and doctrinally separate.[88] German courts still hesitate to reconcile their interpretation of the applicable contract and general private law with the substance of conduct-of-business regulations to the extent these are designed to protect investors. As a result, the "functional fiduciary law" established by the transposition of European law in the German Securities Trading Act, has not yet transformed into obligations under German private law, although, on occasion, it has had an influence on the interpretation and doctrinal analysis of the applicable private law regime.

4.3.3.2 European Law

Similar problems of coordination have arisen in other European jurisdictions. As discussed earlier, different national approaches will come with different results not just in terms of the rights of individual investors, but also in terms of the effectiveness of the regulatory standards as such. It therefore is hardly surprising that the implications of the harmonized conduct-of-business standards should have become the object of a general discussion that transcends the national jurisdictions of the Member States. Significantly, the question whether or not these standards should be interpreted as influencing also the obligations of intermediaries under national contract (and/or general private) laws has been debated not just as a matter of national doctrine (e.g., in order to ensure consistency of obligations and to avoid contradictory sanctions), but also as a matter of EU law.

At first sight, this may appear to be inconsistent both with the fact that the relevant European legislation has never itself prescribed specific sanctions, let alone the introduction of fiduciary principles proper in the national laws of the Member States, and with the lack of legislative powers for the harmonization of general private law in the EU Treaties.[89] Yet, while both aspects remain largely undisputed, it is obvious that differences in terms of obligations under national private law may come with implications for cross-border competition in the Internal Market in at least two respects.[90] First, if and to the extent that national *private* law imposes a stricter standard on financial intermediaries than the standards defined in the harmonized *regulatory* frameworks, intermediaries operating in this jurisdiction face higher costs than they would incur in other jurisdictions where the applicable

[88] *See* Kuntz, *supra* note 10, for a recent analysis and forceful arguments supporting convergence between the two regimes.

[89] *See*, again, *supra* notes 72 and 73 and accompanying text.

[90] For a more extensive analysis, *cf.* Danny Busch, *The Private Law Effect of MiFID I and MiFID II*, *in* Busch & Ferrarini, *supra* note 51, ¶¶ 20.03–20.27 (discussing different scenarios that have arisen in recent practice).

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private law is more closely realigned with the harmonized regulatory standards. And, second, where national private laws are less strict than the regulatory regime, the absence of private law enforcement as a sanctions regime complementing oversight and enforcement by supervisory authorities may impair the effectiveness of the regulatory standards, which in turn may create competitive disadvantages for similar activities carried out in other Member States. Either scenario would be problematic in view of the EU's overarching policy objective to create an integrated Internal Market with harmonized "rules of the game."[91] Moreover, the latter scenario would be inconsistent with the principle of effectiveness, a core principle of European law developed in case law by the Court of Justice of the European Union (ECJ), whereby the duty of Member States to comply with European law implies their duty to provide for effective implementation (including by sanctions in national law).[92]

Interestingly, in spite of these rather obvious consequences, ECJ case law has remained vague in this regard. In a prominent case addressing the question whether MiFID I required the Member States to provide for individually enforceable sanctions for a violation of the know-your-customer requirements stated therein, the Court held that, in the absence of specific EU legislation, the Member States, subject to the principles of equivalence and effectiveness, remained entitled to define the sanctions regimes according to their own preferences.[93] This authority arguably includes the freedom to restrict implementation to *regulatory* requirements without direct implications for obligations under general private law. With the doctrinal debate ongoing, it remains to be seen whether this principle will be upheld in future cases, even if it could be established that the lack of individually enforceable private law duty, in the circumstances, reduces the effective implementation of the regulatory standards.

Whatever the future may bring, both the ongoing doctrinal debate on the private law implications of regulatory standards and the different approaches in place across the EU Member States clearly illustrate that the "transnationalization" of fiduciary

[91] *See*, again, *supra* note 69 and accompanying text.

[92] *See generally*, *e.g.*, Takis Tridimas, The General Principles of EU Law 418–76 (2006); Walter van Gerven, *Of Rights, Remedies and Procedures*, 37 Common Mkt. L. Rev. 501 (2000).

[93] Case C-604/11, Genil 48 SL, Comercial Hostelera de Grandes Vinos SL v. Bankinter SA, Banco Bilbao Vizcaya Argentaria SA, ¶¶ 57, 58 (May 30, 2013), https://curia.europa.eu/juris/document/document.jsf?text=&docid=137832&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=146393; confirmed in Case C-312/14, Banif Plus Bank Zrt. v. Márton Lantos and Mártonné Lantos, ¶ 78 (Dec. 3, 2015), https://curia.europa.eu/juris/document/document.jsf?text=&docid=172564&pageIndex=0&doclang=EN&mode=req&dir=&occ=first&part=1&cid=148968. *See*, for a critical analysis in the light of ECJ case law in similar scenarios, again, Busch, *supra* note 90. And *cf.* Stefan Grundmann, *The Bankinter Case on MIFID Regulation and Contract Law*, 9 Eur. Rev. Cont. L. 267 (also supporting a more extensive interpretation of the regulatory requirements).

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rules for the relationship between financial intermediaries and their customers, despite the high level of global convergence of regulatory conduct-of-business standards, is a process that has not yet reached its end. Only some jurisdictions thus far have resolved the problems of coordination between the two regimes, transforming "functional fiduciary law" into private law obligations in one way or another. In others, the two regimes continue to operate separately, sometimes on the basis of rather vague principles, which creates legal uncertainty for both intermediaries and their customers. It is at least conceivable that future developments, either through changes in the applicable EU legislation or in the form of a revision of ECJ case law, could trigger further convergence in this respect. For the time being, however, convergence with international trends so far has been restricted to the regulatory sphere.

4.4 CONCLUSIONS

Over many decades, regulatory frameworks for the provision of financial services – in particular, vis-à-vis retail customers – have come to complement national contract laws with conduct-of-business standards designed to establish minimum qualitative standards of care, skill, and honesty for the provision of a wide range of services to customers. At least parts of this regime mirror and, to some extent, replicate duties that have also been recognized as fiduciary duties in general private law, particularly because (and to the extent that) the underlying contractual relationships qualify as agency relationships in common law. Modern conduct-of-business standards, developed in order to facilitate the effective protection of investors through ex ante supervision and enforcement of qualitative requirements, thus have come to complement (and, in part, to supersede) functionally parallel duties that would otherwise be enforceable ex post, within the context of individual lawsuits brought by customers against their intermediary. Historically, this development can be explained with the desire to balance out deregulatory developments in US state legislation since the beginning of the twentieth century through the imposition of harmonized standards in federal securities regulation in the 1930s.

This process has been taken up by a global trend toward converging regulatory standards since the 1980s, which – both in international standards (in particular, the IOSCO "Principles") and European legislation – has been driven by the desire to open national financial markets and facilitate cross-border competition for financial services intermediaries. Though certainly onerous in terms of compliance cost, the adaptation and implementation of a growing body of transnational conduct-of-business standards thus certainly has served industry interests. In this regard, securities regulation clearly is in line with the emergence of international standards in other fields of financial regulation, including, in particular, the area of prudential requirements for the establishment and ongoing operations of banking

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institutions – and it is reflective of the relevance of "soft law" as a driving force behind the development of transnational legal orders more generally.[94]

With regulatory (as distinct from contract) law as a platform and transmission mechanism for the emergence of a transnational regime for the regulation of fiduciary relationships between intermediaries and customers, the respective provisions have changed their nature. While the understanding of fiduciary duties and, indeed, their relevance for the solution of problems in the individual contractual relationships differ considerably, especially between common and civil law jurisdictions, the emerging body of principles and duties can nonetheless be described as "functional fiduciary law" – that is, legal solutions to economic problems that arise in agency relationships irrespective of the respective underlying contract law frameworks and their links toward more general principles (good faith, duties of care, skill, and honesty) in the respective legal systems. In this sense, the emergence of a universally accepted body of conduct-of-business standards certainly can be characterized as a successful example of transnational legal transplants.

Apart from the incentives of the regulated industry to accept and implement such standards as a price for unrestricted access to foreign markets, two interrelated aspects in particular appear to have facilitated this development: *First*, regulatory law is, almost by definition, generic in nature, and thus less contingent on functional interlinkages with general principles of contract law, be they rooted in common or statutory civil law. *Second*, precisely because the inclusion of transaction-oriented conduct-of-business standards originally served to compensate for weaknesses in the protection of investors under general principles of fiduciary law, the applicable regulatory standards were at the same time more focused on specific aspects of the intermediary-customer relationships – and simpler to administer. Regulatory conduct-of-business standards apply independently from general principles of contract law. At the same time, they are *not* intended to provide a legal basis addressing all aspects of the relevant relationships, but merely *add* to general contract law by imposing certain protective duties and facilitating their ex ante supervision by public authorities. This allows the implementation and enforcement of regulatory requirements in a way that is functionally and operationally separate from the application of general contract law, which in turn facilitates their "export" to, and adaptation by, jurisdictions with different contract law regimes.

Against this backdrop, however, problems of coordination between the regulatory sphere and the respective contract law environment are inevitable, and it is hardly surprising that such problems can be identified as a common concern in many jurisdictions, including the Member States of the European Union. Realigning regulatory standards with the technical content of applicable contract law and,

[94] On which, *see, e.g.*, Gralf-Peter Calliess & Peer Zumbansen, Rough Consensus and Running Code: A Theory of Transnational Private Law 123–34 (2010/2012 reprint).

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indeed, general principles of contract law (including, for that matter, the common law of agency and fiduciary duties) continues to be difficult, especially in cases where the substantive content diverges. In this respect, ongoing discussions on the private law implications of the harmonized body of European conduct-of-business regulations is just one illustrative showcase. As long as national differences in the treatment (and resolution) of such conflicts continue to exist, the process of "transnationalization" of what could be described as "functional fiduciary law" clearly remains incomplete – with potentially significant results in terms of substantive outcomes. Although the transnational convergence of regulatory standards that can be described as "functional" fiduciary law has made enormous progress over the past decades, the private law regimes applicable to the intermediary-customer relationship continue to differ considerably. International "soft law" instruments are highly relevant, and transnational cooperation of regulatory institutions acting under highly politicized mandates and corresponding restrictions, and influenced by strong market forces, continues. The resulting emergence of transnational standards for the regulation of financial intermediation reflects an ongoing process of transnational legal *ordering*, but does not represent a mature transnational legal order, yet.

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