CONSUMER-PROTECTION
IN CONNECTION WITH THE PROVISION OF FINANCIAL ADVICE

SUMMARY

SUMMARY OF THE REPORT BY THE COMMITTEE ON FINANCIAL ADVICE TO CONSUMERS, SOU 2002:41

The assignment
On the 22nd of May 2002, a committee handed over a report to the government concerning consumer protection in connection with the provision of financial advice. The assignment partly included surveying the current rules applicable regarding the liability and obligations of financial advisors, and also proposing legislation or other appropriate measures that may be necessary. The purpose of the proposal should be to strengthen consumer protection in this field.

General starting points
The operations of banks and other financial service providers have changed. Today, these enterprises provide various kinds of financial services, for example savings products. Over the last twenty years the proportion of adult Swedes who own financial instruments has increased from 20 per cent to almost 80 per cent. To an increasing extent, officers at financial service providers have started to act advisors and sellers of financial services.
The consumer is offered a very large range of investment alternatives with varying risk profiles. This development has led to an increased need for knowledge and information on the part of the consumer. From the consumer perspective, the financial advice given by the financial service providers therefore appears to be a very important operation.

Financial advice – current situation
There is no legal definition of the term ‘financial advice’. However, advice is often generally considered to relate to activities aimed at providing proposals on appropriate approaches in a particular context. The advisor is expected – at least in professional activities – to possess special skills and is expected, relying on this skill, to guide the consumer concerning how they should act in a particular case. Advice is also of an individual nature and aims to provide recommendations and explain alternative courses of action that are designed according to the special needs and desires of the consumer.
However, it is more difficult to define what characterises financial advice under current law in relation to other advice. The activities that are conducted within financial service providers - for example, banks, credit market companies, securities companies, insurance companies, unit fund companies and card companies – are far too multi-faceted for it to be possible to define

them appropriately. However, in the majority of cases, financial advice relates to advice on placement, i.e. advice on placement of the consumer's assets in primarily financial instruments. Today, there is no legislation aimed at the obligations and liability of financial advisors. There are examples of such legislation abroad. However, in Sweden, judicial practice has developed a form of liability to pay damages regarding advice. Through this practice, the liability for financial advisors can also be discerned. This liability can be briefly described as a liability in damages for an advisor who acts negligently. However, the more detailed limits for this liability, i.e. what is required for a financial advisor to be deemed to have acted negligently and thereby liable to pay damages, is not particularly clear.

A new Financial Advice Consumers Act

Set against the above-mentioned background, there is a need for special, consumer protection legislation regarding financial advice. It is therefore proposed that a new law is introduced – the Financial Advice Consumers Act. The Act contains provisions of both a commercial and private law nature.

Scope of the Act

The advice that is proposed to be covered by the Act must be of an individual kind and it is expected that there will be an assignment relationship between the consumer and the advisor. It will doubtless be questioned later whether such an assignment relationship actually prevailed between the parties, as a formal contract concerning advice is rarely concluded. Whether the business acted professionally and whether the customer had cause to understand the situation to be an advisory situation will therefore be decisive when assessing whether an assignment relationship existed. If the business operator for example uses terms such as 'personal advisor', 'financial advisor' or 'personal banker', it should be possible to presume that the business provides financial advice of an individual nature.

General promotion of a product, for example in advertising, is not to be regarded as advice under the Act. Recommendations directed at a wide, undetermined group of people, for example via the media, are not covered either. Nor do execution only services comprise an advisory situation, i.e. situations where the consumer only demands a particular financial service and where the business does not do anything except execute this service.

As indicated above, it is difficult to find a clear and simultaneously comprehensive definition of the concept of financial advice. The scope of the proposed Act must nevertheless be clear and certain. It is therefore proposed that the Act should be directly applicable to advice on placement of a consumer's assets in financial instruments. The Act therefore applies to such placement advice as relates to, for example, shares, unit trusts and bonds. The aim of specifying the scope of the Act in this way is to cover all the usual kinds of securities in which consumers choose to place their funds. A common feature for all these securities is that they involve financial operations that involve a substantial risk for the consumer losing, completely or partially, the capital invested or going into debt.

It is also proposed that the Act is directly applicable to advice on placement of a consumer's funds in such life assurance where the capital is placed in the financial instruments that the consumer decides. In this kind of life assurance (so-called unit-linked policies), it is the consumer who bears the risk of placement and the same protection interest is applicable as in the case of placement directly in financial instruments.

However, there is also other financial advice that may be deemed to be rather important from the consumer protection perspective. In such cases it should be possible to apply the Act by analogy, i.e. the same liability ought to be applicable for those financial advisors who are not directly covered by the Act, but where the protective interest for the consumer appears to be of equally relevant as in the case of advice that is subject to the Act's direct scope of application. The more detailed delineation as regards the application by analogy should be left to judicial practice.

It is proposed that the Act should apply for all business operators who provide such advice that is subject to the Act. It is thus not limited to relate to banks or other financial institutes, even if a large part of the advice that is provided to consumers occurs in this kind of business.

It is proposed that the provisions of the Act are mandatory for the benefit of the consumer.

Advice, marketing or selling?

An important issue in this connection is to clarify how the proposed Act shall react in relation to marketing that the financial service providers direct at consumers and sales of financial services on behalf of these businesses.
A fundamental starting point is that pure advice, i.e. an advisory situation where the consumer only receives advice as a particular service, does not appear to be very common. Instead, in the majority of cases, advice is provided together with marketing of a business's products or constitutes a step in the sales situation. In order to avoid the Act only covering a small part of the advice that is provided, the Act should also apply to such advice as is included as an element of marketing directed towards the consumer or which is provided in conjunction with the sale of financial services to the consumer.
It may be expected that cases will arise where the financial advice is to be assessed according to several systems of rules, e.g. existing private law legislation or the market law legislation. This may be the case if the information that is subject to the advice may, at the same time, be deemed to constitute marketing or information concerning individual products. In these cases the consumer is given the benefit of choosing the most beneficial legislation for him or her.

The business operator's obligations

The businesses that provide financial advice subject to the Act should be obligated to satisfy certain general requirements concerning their operation.
First, it is proposed that the business should be liable to ensure that the personnel who perform advice have the necessary skills. However, the detailed requirements as regards training and experience are not specified in the Act but this is transferred to the relevant supervisory authorities to be determined in detail.
Second, it is proposed that businesses should be liable to document what has occurred at the time of the advice. The Act does not specify the detailed requirements that should be imposed regarding the formulation and content of such documentation. Instead, this may be prescribed by the relevant supervisory authorities. However, it can generally be stated that the documentation should provide such a good view on what the consumer and advisor have discussed that it will enable the subsequent reconstruction of what the parties stated in material respects.
The above-described obligations of a commercial law nature constitute general preconditions for the financial service providers being able to provide financial advice. In this respect the proposal can be said to constitute part of the so-called business operation legislation in the field. However, according to the proposal, an obligation may be imposed on businesses in relation to individual consumers in an advisory situation.
A financial advisor shall, according to the proposal, be liable to observe good advisory practice and shall protect the consumer's interests with care. A corresponding demand on the observance of good practice is already included in other legislation for, among others, real estate agents and insurance brokers. However, the concept of good advisory practice is new in the context of legislation. It is not possible to specify in detail what is meant by good advisory practice. Good practice can be said to be the sum of, for example, the guidelines and recommendations of the sector itself, guidelines and general advice from the relevant authorities and judicial precedents. What may be regarded as good practice will thereby change over time.
The advisor shall also be liable to adapt the advice to the individual consumer's desires and needs. Factors such as the consumer's existing knowledge, financial and other circumstances, the purpose of the placement together with the level of acceptable risk shall form the basis of the advisor's recommendations. The advice that is provided shall be appropriate for the individual consumer.
It is finally proposed that the advisor should be liable to advise the consumer to decline the implementation of such measures that cannot be deemed to be of reasonable benefit for the consumer or which are otherwise inappropriate.

Damages for negligent advice

It is proposed that the consumer is given a statutory right to damages for the damage that may arise as a consequence of financial advice. A precondition for the liability in damages adversely affecting the financial service provider is that the advisor has acted negligently. The assessment of whether an advisor in a particular case may be deemed to have acted negligently, the so-called assessment of culpa, shall be conducted taking into account all the relevant circumstances. Therefore, it is not only the obligations proposed to apply according to the Act

that will be of relevance. However, in the event that an advisor contravenes good advisory practice, or in some other way neglects the obligations in relation to the individual consumer as described above, it should normally be presumed that negligence exists.
It should be pointed out that liability in damages relates to the particular case of negligent advice. By this it is meant that the advisor has exceeded the norms for action which may be deemed to apply owing to law or custom. By introducing liability for negligent advice, it is not intended to introduce an extensive liability for 'bad' advice. The fact that a consumer loses money owing to share prices falling or because interest levels change is not generally the consequence of negligent advice. Subjective assessments of the future development of the financial market should obviously not be made, in view of the prospect of consequent liability in damages. Damages under the Act are thereby neither aimed at compensating the consumer for falls and rises in the financial markets, nor to eliminate the elements of risk that always exist in connection with placements in financial instruments. Instead, the proposed rule on damages is only intended to affect the financial advisors who have acted negligently, which in practice means that it relates to such advisors who in their advisory operations have stood out in relation to the vast majority of advisors.
An exception from the right to damages is proposed as regards petty damage. The aim is to avoid disputes that only have importance for the consumer as a matter of principle.
According to the statutory proposal, it is the obligation of the consumer to present a complaint to the financial service provider within a reasonable time from when the consumer became aware, or ought to have become aware, that damage has arisen. Thus consumer can not act passively in relation to a loss that arises. In order to ensure that the right to damages does not lapse, the consumer must also institute proceedings against the business within ten years from the time the advice was given.
The proposed Act is not intended to be exclusive in the sense that other opportunities to demand damages from the business operator lapse. It is conceivable that there are several situations where the consumer can, on alternative grounds, present a demand for damages owing to financial advice. It may for example be the case that the advisor has by virtue of a guarantee promised a specific financial outcome that is unfulfilled, that the consumer bases his claims on an offence committed by the advisor or that the advice that was given does not fall within the scope of the Act. In this case, the demands of the consumer can be founded on other legislation than the Act now proposed or on general principles of the law of tort.

Supervision

It is proposed that supervision according to the Act, in practice, is allocated between the Swedish Consumer Agency (Konsumentverket) and the Swedish Financial Supervisory Authority (Finansinspektionen). The Financial Supervisory Authority should be given responsibility for supervision as regards such financial institutes that already owing to other legislation are subject to the supervision of the authority, while the Consumer Agency should exercise supervision of other businesses.
Through the proposal, the supervisory authorities obtain powers to intervene against those businesses that do not comply with the Act. The authorities are empowered to verify that businesses satisfy the requirements of the Act by inspections or through requesting disclosure of documents. If it transpires that there are inadequacies in a business's advisory operations, the supervisory authorities may either issue a warning or prohibit the company from continuing to provide such information as is subject to the Act, subject to a fine for default.

Other issues

The consequences of the proposal

The proposal for new legislation may be expected to reinforce consumer protection substantially as regards financial advice. However, this reinforcement cannot be achieved without some increased costs arising for both the relevant authorities and the financial service providers.
Both the Consumer Agency (Konsumentverket) and the Financial Supervisory Authority will be given new supervisory functions and are expected to issue, pursuant to the Act, regulations together with guidelines and general advice. It is necessary to provide special funds for both authorities regarding this work.
It may also be expected that the financial service providers that provide such advice as is subject to the Act will incur increased costs. These costs are referable to the demands on skill

and documentation that are proposed by the Act. However, it is not possible to estimate these costs in figures. The businesses are moreover subject to a statutory liability in damages. However, the costs for any damages may be regarded as negligible for the industry as a whole. The proposal may also be expected to have the effect that the issue of financial advisors' obligations and liability attracts increased attention by the media. The predisposition on the part of consumers to present complaints to the National Board for Consumer Complaints (Allmänna reklamationsnämnden) or public courts may thereby increase. Furthermore, the needs of the consumer for information and guidance on these issues will increase. However, as regards this question, it is not possible to estimate any costs in figures. As regards the consideration of matters of damages by the National Board for Consumer Complaints or public courts, the Act may have the opposite effect. By virtue of the proposed Act enhancing certainty as regards the obligations and liability of financial advisors, it may be expected that a larger number of matters may be resolved without being considered by the Board or a court. The consideration that nevertheless takes place will doubtless also be facilitated by the proposed Act.

Entry into force

It is proposed that the Financial Advice Consumers Act enters into force no earlier than 1 July 2003.