MISLEADING ADVERTISING AND GUARANTEE OF CONFORMITY IN INVESTMENT CONTRACTS: LOOPHOLES IN THE ITALIAN FINANCIAL REGULATION

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\textbf{Keywords:} Financial Advertising, Investments, Issuers, Intermediaries, Consumers, Contractual and pre-Contractual liabilities

Legislative Decree No 21 of 21 February 2014 has made significant changes to the regulations of the Consumer Code on consumer, distance and off-premises contracts. This has been a good achievement.

Today I would like to discuss what I consider a new target for us to approach - also in respect but not limited to online trading -, in the distribution and subscription of investment products for "consumers" (in slang: "retail" customers). I am referring, in particular, to the proposed extension of the principles adopted by the Consumer Code on the legal guarantee of conformity for subscription of investment products.

1. The proposal stems from the observation of the circumstances in which the typical private investor invests in bank bonds or corporate bonds or subscribes fund units and who occasionally takes risks on the stock market, investing only in the most popular companies. Said investor is not a finance expert, "listens in" on the financial daily press and sometimes visits the financial blogs - but because of the technicalities, normally 'leaves'. He is physiologically attracted to, and more willing to entrust his savings to, the issuers and asset managers best-known on the market, supported by a brand image, as they say, of outstanding expertise and reliability.

2. Advertising, as an instrument of knowledge and public dissemination of proprietary brands and products, plays a key role in generating the confidence and, hence, the propensity to invest - in short: the expectation that will lead the investor to buy. I am referring, on the one hand, to "institutional" advertising, in which the "the producer's" brand is normally extolled (i.e. that of a bank, investment company, asset management company) ("the bank that I want" WEBANK; "the bank built around your needs" MEDIOLANUM; "life is full of ups and downs, we’ll be there in both cases" UNICREDIT; "Your money always at hand" PICTET).

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\textsuperscript{2} Article based on the speech given at the conference: "Diritti e benessere del consumatore nell'ecosistema digitale", Rome, 14 May 2015.
But I'm also referring to product advertising, that is, to those television or radio advertisements that always end with an ultra fast-paced 'caveat' or with a minimal disclaimer (advertising on the press or the internet) inviting the listener to read the information note beforehand. These advertisements obviously enhance the features and quality of the products.

As stated above, advertising communication disseminated directly and in any case created and promoted by broadcasters and operators of high renown to extol the expected performance and reliability of their product, can sometimes constitute the primary (that is, the initial and determining), and in any case, significant and contributing source of expectations for the investor seeking the most profitable and secure investment.

3. The typical retail investor, therefore, turns to the "seller" (banks, investment firms) and usually selects from among the solution offering that already promoted by the build-up advertising campaign, which has tempted him to buy, and which the distributor-seller will support with additional arguments and documentation. The brand is famous, the messages highlight the substantial benefits. However, the time eventually comes when the investor suffers heavy losses, a case erupts and he also finds out that those extolled virtues and information that he received prior to the negotiation were misleading and false.

4. Is there adequate protection for the unfortunate investor? Said protection, I would add, is governed by private law (even though, as I will discuss later, a virtuous synergy with public law on PCS entrusted to the AGCM may well be envisaged).

Advertising in the finance sector is regulated vis-à-vis both issuers (companies, funds) and intermediary distributors (banks, investment firms). Article 101 TUF regulates "advertising" and, in particular, "any kind of advertising relating to an offer" (i.e. "product", not "institutional", advertising) by providing, on the one hand, for its transmission to Consob at the time of dissemination and, on the other hand, for its consistency "with that contained in the product statement". Articles 34-octies et seq. of the Issuer Regulations and Articles 27 et seq. of the Intermediaries Regulations specify, in relation to the subjective differences between the two operators, the terms and limits of advertising content, including the ritual warnings, which mainly recommend the subscriber to carefully read the information document prepared by the issuer and that it is the intermediary distributor's responsibility to provide said document to them.

In this context, I would first like to stress that the transmission to Consob of product advertising and commercials does not imply that said Authority will carry out a preventive check. Article 101 states that the transmission to Consob must occur at the time of dissemination and without the Authority's prior approval. As a result, the use of misleading advertising in the finance sector is certainly not averted by the aforesaid provision, since the Authority can intervene only after the information has been disseminated. Note, in any case, that the control exercised by Consob amounts essentially to a formal verification that
the content requirements of advertising messages have been satisfied, without checking the actual "substance" of the message, which, moreover, would require a particular sensitivity to the consumer universe, such as that, specifically by tradition and competence, of the AGCM.

It should also be noted that the issuer's failure to disseminate information in conformity with the sector regulations referred to above does not have a direct effect on the investment contract signed with the investor\(^3\). According to the legislative scheme regulating the financial investment sector (TUF and the implementing regulations cited above), advertising (that stemming from commercials developed and disseminated upstream by the issuer) is not a requisite and binding informative component for the subsequent subscription of the financial product.

In more technical terms, the obligations imposed on intermediaries to provide prior information at the time of signing of investment orders (Intermediaries Regulations, Art. 22 et seq.), "supersede" - 'set aside', so to speak - any previous false advertising attributable to the issuer.

In short, as a result of the written and oral pre-contractual information that the distributor is required to provide, and that the customer only receives after the financial product has been advertised before the "purchase" of the product itself, the customer will ultimately be unable to claim effectively that he subscribed to the financial product as a result of, or also due to, the misleading contents of the advertising message. In this way, the customer will not be able to invoke the responsibility, or co-responsibility, of the issuer.\(^4\) The issuer ... pulls away, so to speak, and the only person liable to be accused is the distributor-vendor for the representations and information that the same distributor has provided to the purchaser.

NB: naturally, the related administrative liability still rests with the issuer and/or intermediary distributor, arising from the violation of the regulations on advertising (always understood as commercials) of financial product offerings (within the competence of Consob) and from the violation of the rules on unfair commercial practices contained in Articles 20 et seq. of the Consumer Code (within the competence of the AGCM as a result of Art. 27 (1bis) of the Code introduced by Art. 1 (6) (a) of Legislative Decree No 21 of 21 February 2014). Subject to the foregoing - which, moreover, in the reformed view called for here, could make a powerful contribution to civil law protection in terms of finding and determining the misleading nature of the information provided to customers - subject to the above, I was saying, the author of the 'primary' (in the double sense mentioned above) misleading advertising is, as it were, "immune". The implicit hypostatization here is that the investor has decided to sign the product solely on the

\(^3\) Unless – it goes without saying – the customer purchases directly from the issuer.

\(^4\)
basis of the pre-contractual information provided to him by the intermediary distributor, and no causal link can therefore be established between the harmful event and the misleading nature of the contents of the "upstream" advertising campaign. Said hypostatization is, however, unrealistic and hypocritical, as is that of denying a priori the effectiveness, at times decisive, or – depending on the circumstances – partly responsible in determining the expectations raised by the issuer, and intended solely to exempt the latter from any responsibility or, at least, co-responsibility.

5. Such a solution is unacceptable. It is inappropriate and unreasonable and, hence, inadmissible to exclude a priori the causal or partly causal relevance that the falsehood of said 'original' advertisements has in terms of obtaining the purchaser's consent to buy. Such relevance, as noted above, is all the more evident if the advertising is made by issuers or investment companies of high repute. It is also unacceptable in the substance that the legal provisions in force hypostatize this causal or partly causal effect – depending on the case – of creating the purchaser's expectations as fully evaporated or consumed, simply because of the additional information provided by the intermediary distributor at the 'negotiation' stage. Moreover – as a further argument – the burden of pre-contractual information referred to in the Intermediaries Regulation is normally fulfilled through the actual delivery to the customer of the hefty documentation on the investment risks, the hefty information documents on the issuer and the hefty information documents relating to the contract. It is a widely known and entirely "physiological" fact, moreover, that at the time of signing the contract, the intermediary distributor does not point out to the "retail" customer the specific clauses that would likely dissuade the subscriber from acting upon the erroneous belief into which he was led by the content of the advertising campaign carried out 'upstream' by the issuer. He would be immediately and dishonourably 'sacked' for doing so!

6. This lack of protection in the sale of financial products is worrying, especially when compared with the legal provisions in force simply on the sale of movable goods. These provisions expressly acknowledge the causal relevance of advertising also by the producer in determining the consumer’s expectations, pursuant to the legal guarantee of conformity of Articles 128 et seq. of the Consumer Code – said provision, moreover, does not apply to investment contracts, (specifically referring to "consumer goods").

In particular, Art. 129 (2) (d) of the Consumer Code provides that "Consumer goods shall be presumed to be in conformity with the contract if", among other things, "they show the quality and performance which are normal in goods of the same type and which the consumer can reasonably expect, given the nature of the goods and taking into account any public statements on the specific characteristics of the goods made about them by the vendor, the producer or its agent or representative, particularly in advertising or on labelling".

This rule represents a major leap forward in regulating the structure of liability for the sale of movable goods, in that it specifically
provides that the content of advertising messages in any way disseminated (by the seller but also by the producer) has the same effectiveness as contractual and pre-contractual statements (whether in the 'negotiation phase' in the strict sense or, more broadly, during the "preparation of the contract" – Art. 1337 of the Italian Civil Code). There is no doubt, under the aforesaid rule, that if the vacuum cleaner purchased by the consumer does not have the suction power promised in the advertising, the consumer will have the right to rely on the guarantee of conformity provided to him under the code and to make recourse to the legal measures in place in order to obtain, in the alternative, a compliant product, a price reduction or the cancellation of the contract of sale.

If, therefore, said protection is provided to consumers in the purchase of ordinary consumer goods, there is no reason why there should not be the same protection for the "retail" customers of issuers and intermediary distributors of financial products in the savings collection sector. This sector, moreover, clearly exposes the investor to much higher risks than those associated with an inefficient vacuum cleaner.

The obvious consideration that the protection provided to investors is the same as that provided in the area of public savings, supported by the constitutional guarantee under Article 47 of the Charter, clearly suggests the need to adapt the related legal and regulatory provisions, at least in favour of the less experienced "retail" investors. Thus, the advertising of financial products and the features advertised therein should be duly attributed the causal and partly causal relevance in assessing the conformity of the financial product with the contract.

(In this context, the intervention of the Supervisory Authority in the sector, namely Consob, would also be called for, which, by virtue of the regulatory powers conferred upon it under Article 101 (3) of the TUF on financial advertising, could reform the Issuers and Intermediaries Regulations by including in the code an explicit evaluation of the advertising disseminated 'upstream' from the contractual stage in order to assess the conformity of financial products).

8. This is an opportunity to set ourselves another target. As noted above, the use of advertising contents as part of the elements that can be used to evaluate the guarantee of conformity of financial products would allow to bring action for damages resulting from breach of contract also against the issuer, in the event of non-transparent or misleading advertising.

The initiation of direct action (also) against the issuer may well find a legal justification in light of the qualified "social contact" that is established between the issuer and the investor specifically on the basis of the expectations raised (mainly or, in any case, also) by the promotional advertising campaign carried out by the former, and that, as reiterated, will be 'reflected' in the stipulation. The level of responsibility should therefore be at least equal: the intermediary-vendor should be responsible for its representations during the negotiation phase in the strict (and, specifically,
implementing) sense, and the issuer should be responsible for its 'original' representations which, in each case, influenced the buying decision.

More specifically: when the issuer is also extraneous to the intermediary distributor's fulfilment of its own disclosure obligations (disclosure requirements which must be fit to ensure an "informed investment" on the part of the latter), the issuer must in any case be subject, vis-à-vis the investor who has decided to subscribe to the financial product on the basis of information publicly disclosed by the same issuer, to the obligation to ensure the conformity of the financial product and to pay damages when a case of non-conformity is found. The source of the obligation is the dissemination of false information (classified as a "fact ... causing unfair damage to others", or as a violation of correct information duties "in the preparation of contracts": see here below), as deemed fit to distort the buyer's expectations.

In conclusion, I would like to briefly conclude on the above-mentioned imputation of pre-contractual liability. Said imputation relates to the 'social contact' between issuer and buyer specifically as a source of responsibility (or co-responsibility) as a first, but also third party, technically speaking, to the contract. This hermeneutic approach was established in the second half of the last century by authoritative German jurists (such as Schlegelberger-Hefermehl, Ballerstedt, Rehebinder), with particular reference to the producer's responsibility for damage caused by products, (in this context see today, on the wake of the European Directive, the provisions of the Consumer Code, Article 114 et seq.).

The reference to the aforesaid literature is still relevant today. In the specific matter at hand, the reliability of attributing the "social contact" to the sphere of contract formation (an area in which the producer acts as "persoenlicher Traeger des Verhandlungsvertrauen": Gloeckner) is supported by the consolidated guidelines of the Banking Financial Arbitrator (opened in particular by the Board of Milan) aimed at recognising the passive legitimacy of the bank also in the absence of contract with the applicant in the event of claims against the bank's negligence, which has caused financial damage to the same applicant.  

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