

On Supervision of Financial Markets by Czech National Bank

(focused on Consumer Protection in the Financial Markets)

This work deals with the consumer protection in the financial markets in the Czech Republic.

The opening part of this thesis briefly describes the situation in Czech(oslovak) legislation before 1989. The governing system was not at that time conducive to significant economic activity and the scope of financial markets was limited. As a consequence, legislated protection of market participants had not to be extensive.

Need for consumer protection increased after the then-prevailing economic model had been changed into the current market-oriented model. The expansion of economic activities, including the development in the financial markets, necessitated simultaneous passing of updated law more suited for the new social circumstances. Owing to the preparation of the Czech Republic's entry into the European Economic Community at that time, it was necessary to harmonize the new Czech law with the laws of the Community. Besides the change of the „Code civil“ as a basic regulation of private law, new specific regulations have been passed - for example the Consumer Protection Act or the Consumer Credit Act. In connection with the formation of capital markets, it become necessary to issue entirely new regulation of the market rules, including regulation of the institutional entities and individuals participating in the market activities. Important part in creation of the rules relevant to the capital markets is (also) coordination of overseeing of the market and its protection under the umbrella of the governing laws.

In view of the Czech Republic joining the European Economic Community in 2004, the significant part of this undertaking is devoted to the Community's consumer protection law. The European Economic Community and the current European Union consider consumer protection to be an essential condition for successful establishing of the common market, which is considered as a free movement of citizens, goods, services, and capital. Any inequalities in consumer protection laws, if adopted in different member states of the Community, could discourage the consumer from one member state from purchasing goods or services in another member state. To overcome these inequalities, the existing rules and laws are being gradually harmonized by means of the Community directives. This harmonization was initially introduced as a „minimum harmonization“, which meant that

the Member State could have passed or kept some other law deemed to provide better consumer protection than would the law established by the harmonizing directive. Due to the persisting significant differences which resulted from the "minimum harmonization", the newly adopted directives are based on the full harmonization, and the member states are not allowed to deviate when implementing the details.

Attention is given for example to the directive 85/577/EEC to protect the consumer in respect of contracts negotiated away from business premises, the directive 97/7/EEC on the protection of consumers in respect of distance contracts, which were replaced by the directive 2011/83/EU on consumer rights effective December 13, 2013. Another important directive is the directive 93/13/EEC on unfair terms in consumer contracts.

For example, consumer protection in the financial markets has been addressed by the directive 87/102/EEC for approximation of the laws, regulations and administrative provisions of the Member States concerning consumer credit, and this directive was replaced by the directive 2008/48/EC on credit agreements for consumers. Important for financial services is the directive 2002/65/EC concerning the distance marketing of consumer financial services.

For illustration purposes, this part contains also judicature of the European Court of Justice. The Court in its judgments interprets the *acquis communautaire* for the national courts.

Existence of the authority responsible for supervising the transparency and fairness of the capital market is essential for consumer protection. This work therefore mentions both, the supervision authority in the Czech Republic as well as the organization newly established on the Community level in connection with the financial crises of 2008 – 2009. For comparison, information on market-supervision authority in the United States is presented.

Not only is the consumer protection provided by the supervision authority within aim to make the capital market function properly - this is guaranteed by the administrative regulation or, if applicable, by the criminal law - but there is also the important protection of consumer, i.e. investor, property. This protection of investor assets is provided by specialized funds designated as a reserve for the event of bankruptcy or other failure of brokers and other authorized entities offering their services in the financial markets. The attention is given to these guarantee funds in the Czech Republic and to related Community legislation:

For example the directive 94/19/EC on deposit-guarantee schemes and its consequential directives 2005/1/EC and 2009/14/EC which have increased the limits of bank deposit compensation, or the directive 97/9/EC on investor-compensation schemes. Furthermore, a proposal for preparation of a directive of insurance consumer guarantee schemes is discussed.

Again, for comparison, attention is brought to the subject protection offered to investors in the United States by authorized bodies, including the range of available compensation. In order to provide a better view, some brokers' information on the amount of insurance of investors' property over the applicable legislated limits is added.

Protection of consumers' individual interest is provided by the administrative law, and by the civil law. The Community law stipulates that the Member States also accommodate out-of-court solution of legal disputes between entrepreneur and consumer. The purpose of this rule is avoid the situations involving lesser disputes, where the consumer may otherwise opt to simply concede his legal rights in order to avoid time, expenses, and complexity connected with litigation in court. In the Czech Republic, it is possible to settle general disputes by arbitrating; disputes originating from payment activities (and now also disputes related to consumer credit) can be mediated before the Financial Arbitrator.

Consumer protection provided by the administrative law and administrative prosecution are entrusted to the Czech National Bank when involving individuals within its authority; all other cases fall under jurisdiction of the Czech Trade Inspection. By overseeing the financial markets the Czech National Bank contribute to their transparency and stability, and as a consequence protect consumers and investors who depend on services offered by the entities and individuals tasked with maintaining the market activities. Owing to the fact that protection of privacy of the market participants is important for the financial markets to function properly, the Czech National Bank is required to maintain a strict code of non-disclosure and silence.

The Czech National Bank does not only supervise the system of the financial markets, which includes the entities and individuals running the market activities, the consumers and investors and their interaction, but it is also expected to protect the consumers. A specific question, that is in the current Czech law addressed insufficiently, is settling consumer complaints involving the service personnel working in the financial markets on behalf of the Czech National Bank. The Czech National Bank as a market-overseeing authority

performs a dual role. On one hand, it supervises the financial markets as a system, and on the other hand it should answer individual consumer complaints regarding persons subordinated to its supervising authority. While a legitimate complaint could provide an impulse to exercise unscheduled supervision, acting upon the complaint could prove difficult because of the Bank's duty of silence with regard to the consumer lodging the complaint. This conflicting condition could present a good reason for establishing a special body, independent of the Czech National Bank, to handle the Bank-related complaints.

A very important part of protection of consumers in the financial markets is not only their own level of knowledge of the markets and of services and products offered, but also their understanding of legal surroundings, perception of justice, and respect for others. The legislated regulation itself is insufficient for complete protection of the consumer, unless the consumer has his own interest in protecting himself, instead of - in some cases - even acting in the way that make the use of protection offered by the law complicated or nearly impossible.