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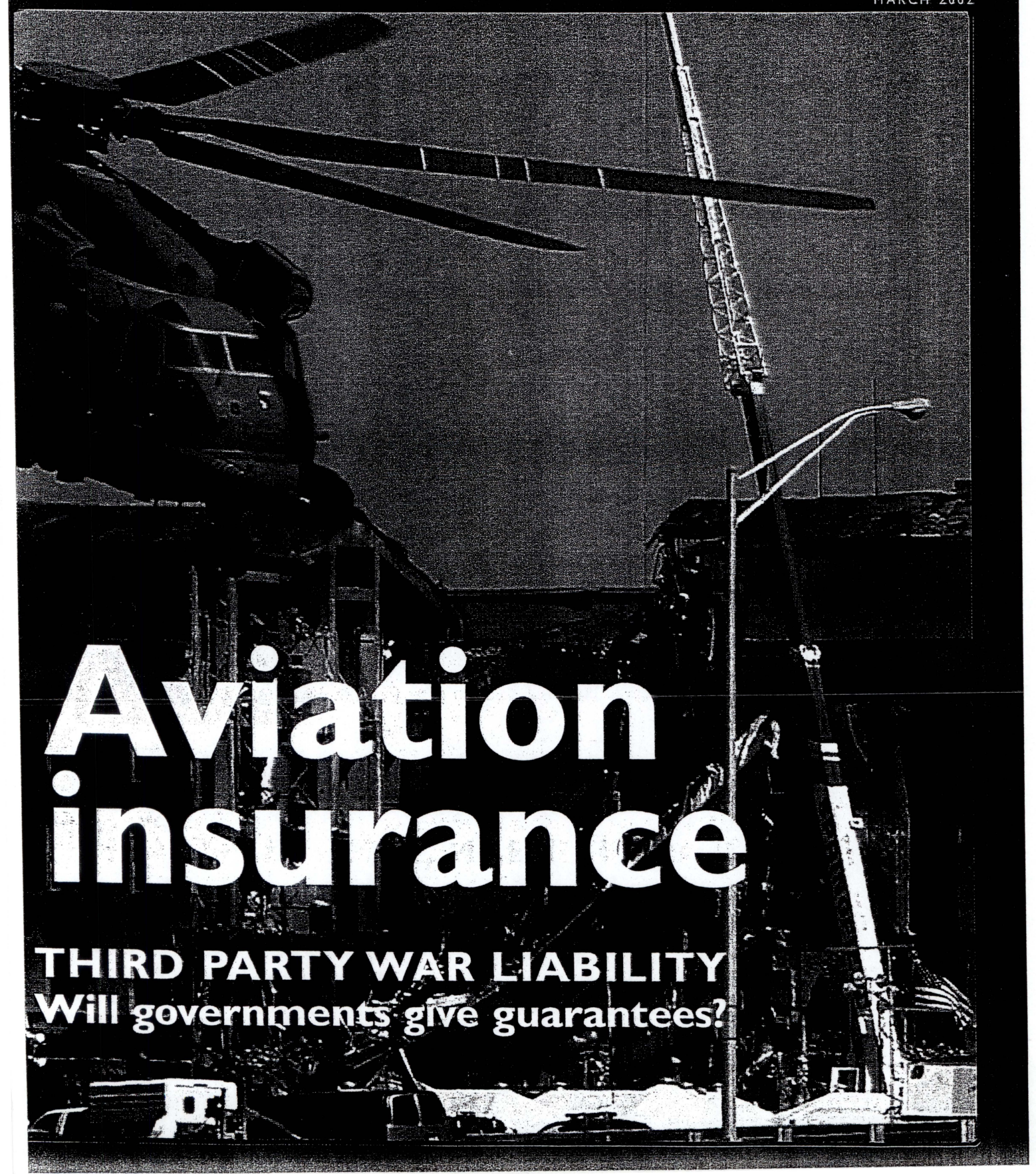
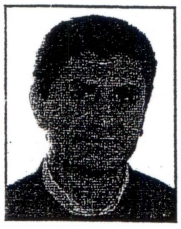


Aviation insurance

THIRD PARTY WAR LIABILITY
Will governments give guarantees?

Some reflections on the Maltese position



David Fabri LL.D.

Allies or strangers?

These past 20 years have witnessed very substantial developments in the legislation relating to consumer protection and the provision of financial services. During this period, the law in these two areas has evolved rather rapidly and beyond recognition. However, it is not always easy to decipher whether and how the two sets of laws dovetail with each other. It would be therefore interesting to explore whether the two sectors constitute a coherent framework and whether there are lessons that two sectors may learn from one another. Many of the legislative changes were home-grown, but significant influence has been predictably exerted by the island's moves towards accession to the European Union. Indeed, one may claim that in the past 10 years, EU law has become the most important inspiration for new legislation.

Independently of the growing EU influence on both its formal and substantive aspects, the Maltese legal system already presents a sophisticated and comprehensive framework. It is also an increasingly complex framework. One can speculate whether the complexity of our legal framework may be a reflection of the varied foreign influences that have designed the island's history. Over the years, Malta has been ruled by a series of foreign powers too numerous to list. These have included the Romans, the Greeks, the Phoenicians, the Kingdom of the Two Sicilies, the Knights of St. John and, albeit for a few years, the French under Napoleon. For long stretches of its history, the island used to form part of the Italian mainland to its north. More recently, roughly between 1800 and 1964, Malta formed part of the British Empire. For all these reasons, Roman law, Italian law and English law have all contributed towards the development of Maltese legal rules and culture.

While most of public law is inspired by the UK practice, the country's private law is largely continental. Malta is basically a civil law jurisdiction, and much of its law has been codified. Five codes of law still provide the bulk of Malta's civil and criminal rules and procedures, closely following the model originally introduced by the Napoleonic Code Civil. This system, which traces its origins to Roman law, still prevails in large parts of Western Europe including France, Italy, Belgium and Germany. It is interesting to note that the codified system on the continental model was introduced here in the second half of the 19th century during the British administration which had been governing the island as a crown colony since the overthrow of the French occupying force. The original idea to introduce the common law system of law was scrapped following resistance from the local judiciary and professional classes.

To this day, Malta follows what is usually referred to as the continental model of private law. Accordingly, as a rule, English common law does not apply. Nonetheless, the influence of the common law is greatly, if indirectly, felt in certain sectors of local commercial practice and regulation, including company legislation and administration, in insurance and banking which have traditionally closely followed practice in the United Kingdom. Most recent local legislation, including the various financial services laws adopted in 1994, owe some debts to equivalent UK statutes. The Investment Services Act borrowed concepts from the equivalent English law at the time, the then Financial Services Act of 1986; the same applies to our shipping, insurance, money laundering and insider dealing laws, to mention a few other instances. Several parts of the new Companies Act represent a simplified version of the English Companies Act of 1985, incorporating many of the provisions dealing with the limited liability company, accounting and auditing requirements and winding-up. Since 1988, Malta has also been progressively introducing within its legal system the English common law concept of trust.

It may therefore be legitimate to suggest that the Maltese legal system absorbed a number of different legal and cultural influences from the two European countries which have shaped a large part of its history, and whose cultural influence remains very high to this day: Italy its closest neighbour to the north, and Britain. Currently, EU laws have become the most important source of new legislation and policies.

The promotion of the island as an open financial location may be viewed as part of the move away from undue dependence on manufacturing. The Maltese economy is becoming increasingly dependent on the services sector which has been gradually replacing manufacturing as the primary creator of jobs. Malta has no raw materials and its main resource is probably its well-educated bilingual workforce and strategic position in the Mediterranean. Like the tourism industry, the financial services sector has expanded rather rapidly over recent years, and as new services and investment opportunities are made available to the Maltese consumer-investor, new additional rules have had to be formulated in order to guarantee high standards of performance by operators as well as minimum levels of protection for investors.

Scope of the paper

Maltese consumer legislation and financial services legislation have only recently achieved a degree of complexity and sophistication. The two sectors have evolved separately and distinctly. One of the main reasons is that they traditionally fall under different ministries, with their own policies and priorities. The object here is to briefly look at these two areas together, examine their interaction, if any, and try to assess whether the result is one of harmony and coordination or one reflecting confusion and ambiguity. Thus the subtitle "Allies or Strangers?". This exercise shall require a brief overview of the evolution and current state of Maltese legislation on general consumer protection and financial services.

This paper must therefore be concerned with the legal position and status of what we may describe as the ordinary general

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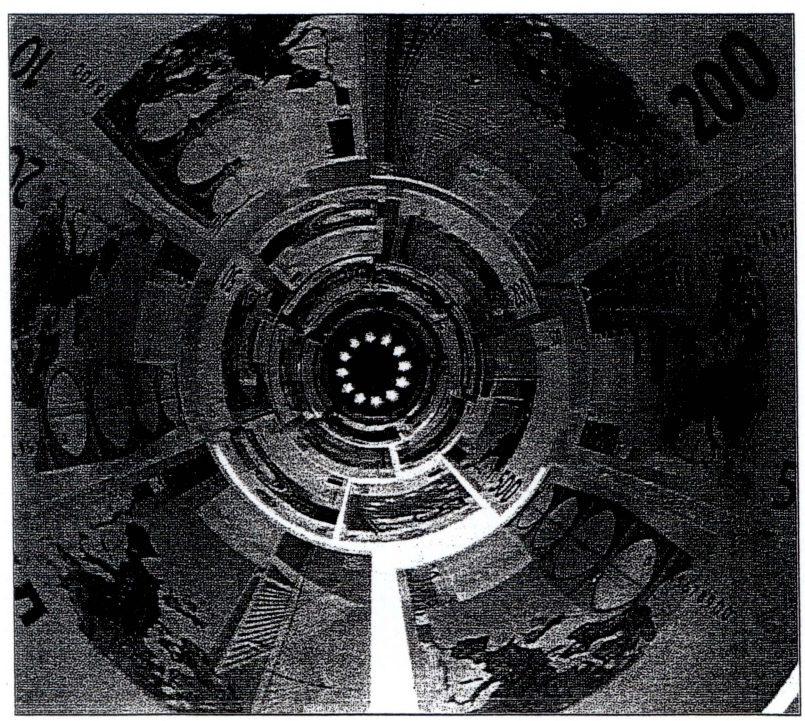
consumer, or more specifically the consumer of financial services. This exercise shall serve as an occasion to consider the basic elements constituting financial services legislation and investor protection in Malta, and the safeguards available to the individual investor. Inevitably, one shall find that consumer and investor protection are conceptually close and inevitably overlap in a number of respects, often not easy to detect.

The notion of a consumer

So at the very outset, a fundamental question in consumer protection: who is the consumer? The concept of the consumer in Maltese legislation is of recent origin. The bulk of Maltese private law is still incorporated in the Civil Code drafted in the late 19th century on the model of the Code Napoleon. The Code still today provides the bulk of the rules governing contracts in general, the contract of sale and the supply of services. It will consequently come as no surprise that the notion of consumer protection and the figure of the consumer had not yet been adequately identified or developed at that stage. The word "consumer" is conspicuously absent from the Code which did not and still does not recognise the figure of the consumer as such. Much of the original Code is still in its original shape and some of its rules do not reflect the modern, complex, dynamic society of today, and sound archaic both in concept and in formulation.



In the law of sale, to take just one important illustration, the Code recognises the figures of the vendor and the purchaser. With the exception of some old traditional rules safeguarding the position of minors, women and persons of unsound mind, all purchasers are considered and treated equally and uniformly by the Civil Code. This guaranteed a minimum level of protection in the form of the Roman law-derived warranties in the rules governing the contract of sale. The first of these warranties relates to peaceful possession; this safeguards the proper passage of ownership rights and consequential enjoyment of the good being acquired. Secondly, the warranty against latent defects gives a purchaser a choice between two remedies when a thing bought suffers from a serious defect which renders it partially or completely useless. The choice is between retaining the item and receiving a partial refund, and returning the item and receiving a full refund. Finally, where a thing acquired falls short of the type or quality specifically promised by or requested from the seller, the purchaser is allowed to withdraw from the contract and receive a full refund.

No attempt is made in the rules governing the law of sale to draw any form of distinction between purely private purchasers on one hand, and business, professional or other non-private purchasers on the other. That conceptual distinction, vital for a coherent consumer policy, came much later. There is still no clear suggestion in the Civil Code that persons transacting from different, often unequal, economic and bargaining backgrounds merit different treatment, except in very limited circumstances. Caveat emptor and the sanctity of contracts still underpin our Civil Code, where the consumer remains a solitary anonymous figure, whose vary existence remains unnoticed.

The Civil Code also provides the basic rules governing the contractual relationship between a service provider and a client. The rules governing the institutes of mandate, letting of services and generally most of the law of obligations would need to be considered to have a full appraisal of this relationship. The laws on the specific financial services, such as the Banking Act and the Investment Services Act have only a minimal private law element, at most, and are primarily of a public-administrative law nature. This means that one would search in vain for a definition of a bank-client agreement in the Banking Act, or for an indication of the legally enforceable rights of a client against a licensed operator in the insurance legislation. One would have to search elsewhere, primarily the Civil and Commercial Codes and decided cases in Malta and abroad.

An initial trilogy of consumer legislation

The beginnings of what may be termed Maltese consumer legislation may be traced to the 1980s. During this decade, Parliament adopted a succession of three separate laws which for the first time specifically addressed the legal status and protected certain identified rights and interests of the consumer. They were the Consumers Protection Act of 1981, the Trade Descriptions Act of 1986, and the Door-to-Door Salesmen Act of 1987. These three laws revealed a piecemeal approach unsupported by a general coherent philosophy or vision. The 1981 Act recognised for the first time the figure of the consumer, and the 1986 Act helped to strengthen the notion further.

The 1981 Act only referred to goods and was generally limited in scope and badly drafted. Its only claim to fame is the rule that recognized consumer associations are exempt from legal liability for public statements intended to protect consumers' interests. This rule survives in the more recent Consumer Affairs Act.

The Trade Descriptions Act of 1986 distinguished between the professional vendor who sells in the course of a trade or business, and the private vendor who does not sell in the course of a trade or business. Its provisions do not apply to sales between private individuals. Like the UK original from which it was copied, the Act (i) extended its protection not only to the consumer but to any buyer who enters into a transaction with a trader, including another trader; (ii) is rather weak with regard to trade descriptions in the course of a supply of services where the prosecution has the added burden of proving that the offence was committed knowingly. > 51

49 > In any event, there is no record of any successful prosecution under this Act. Apparently only a few prosecutions have been commenced since 1986. New rules on misleading advertising were lately added to the Consumer Affairs Act.

For reasons of political correctness, the Door-to-Door Salesmen Act of 1987 has now been renamed the Doorstep Contracts Act. Following the 2000 amendments, this Act is now fully aligned with the EU Doorstep Contracts Directive. It now applies to all other services sold to consumers on a door-to-door basis. Originally, the Act had applied also to insurance, but this feature was removed some years ago.

Despite some initial hesitation and uncertainty in their conceptual formulation, these three laws collectively helped to evolve at least three relevant conceptual innovations:

- a broad distinction between the private ordinary consumer who acquires goods and services for personal and domestic needs, and other buyers of goods and services who buy in the course of a profession or a trade;
- a broad distinction between traders who pursue business ends, and other sellers of goods or services when only acting in a private non-commercial capacity; and
- new specialised techniques of protection are required to safeguard consumer rights and legitimate expectations.

These distinctions have now been further developed and crystallised in the Consumer Affairs Act, 1994. These recent legislative initiatives have highlighted the new thinking that circumstances warrant a distinction between one type of purchaser and another, between a private consumer and a professional or commercial purchaser. Basically the difference is between persons acting in furtherance of trade or business, and persons acting solely for their private domestic purposes. No such distinction, or anything nearing it, is made in our Civil Code. But now, in its increasing sophistication and awareness, the law recognised this conceptual demarcation and has started to intervene to redress the imbalance of information and bargaining, economic and often also political power that often exists between the individual customer and the commercial enterprises with whom he transacts. Despite the 1994 Act, the Civil Code remains of significant importance in any examination of consumer law because it still provides the basic rules of the law of sale and the law of contracts, two institutes of constant relevance in consumer protection. Regrettably, as already remarked, the Code seems to have remained fossilised in a pre-industrial past where life was relatively simpler and consumer goods were relatively uncomplicated and where the market was not the mass market of today.

Most discussions on consumer protection originally only considered as the typical consumer the private individual who purchases for his own use or consumption (and that of members of his family and his friends) goods or products from a shopkeeper or commercial establishment in return for an amount of money paid as the price in consideration of the purchase. The subject of the purchase would typically be an article of everyday use, such as food items, books or stationery, or even a television, refrigerator or car. The Consumers Protection Act of 1981 and the Door To Door Salesmen Act of 1987 originally mainly referred to the purchase of goods. Clearly, this approach was unduly limited and unjustifiable.

The legal rights and the practical risks and potential problems of a consumer of goods are different and may often differ considerably from the rights, risks and potential problems that may concern an acquirer of services

There is now broad agreement that the term "consumer" also includes the customer who orders furniture items from a carpentry firm, books a holiday package tour, engages a technician to repair his television set or refrigerator, or engages the services of a financial services intermediary. In other words, the consumer is also the individual physical person who for private domestic purposes (meaning not connected with his business or profession), acquires specific services offered and provided by persons engaged in providing them in the course of trade in return for a fee.

The legal rights and the practical risks and potential problems of a consumer of goods are different and may often differ considerably from the rights, risks and potential problems that may concern an acquirer of services. The legal actions and remedies available are different. The Civil Code treats the two categories quite differently. As a broad assessment, one may suggest that the situation appears particularly unsatisfactory for the customer who is given by a bad deal by a service enterprise, e.g. one who has ordered furniture for delivery by a specific date, only to find the delivery date receding repeatedly into the future accompanied by broken promises and assurances. The legal provisions governing the rights of consumers of services are relatively under-developed, and the remedies are rather inadequate and require updating. A recent amendment to the old Civil Code provisions regarding the supply of services has clarified further the legal position of a customer who wishes to withdraw from such an agreement.

The Consumer Affairs Act is now the single most important consumer law and should be examined more closely on its own merits. It was substantially amended in 2001 and is now a much more substantial and comprehensive law. The amendments added a variety of new important provisions, some of which directly intended to transpose EU consumer protection directives.

A note on the Consumer Affairs Act, 1994 (as amended in 2000)

Whereas this Act can rightfully claim to be the single most important current piece of legislation in Maltese consumer protection law, it is not a comprehensive all-inclusive law incorporating all existing consumer protection measures. Nor should it be viewed in a vacuum, but it ought to be viewed against the backdrop of other measures that have been adopted during these past 100 years. Some of these measures, including the Civil Code, are still with us. The new Act has undoubtedly met its objective of serving as a platform and as a framework for eventual new consumer measures, including the vast programme of provisions added in 2000.

The Act was largely based on the detailed programme originally proposed in the 1991 White Paper - "Rights for the Consumer". This White Paper was intended, first, as a comprehensive stock-take of the nature, extent and deficiencies of consumer protection rules and measures at that point in time, and secondly, as a point of departure and reference point for future discussions on the subject.

The first actual draft bill of a new consumer law was eventually published in 1993 attached to a second White Paper - "Fair Trading... the next step forward". (Two separate White papers on consumer policy were published in the space of three years.) This was one of the first and one of a very few documents that considered consumer and competition matters together. Despite acknowledging their common goal of ultimately benefiting consumers, this White Paper highlighted the then government's intention to have them separately regulated. The draft bills attached to it were later to form the basis of the Consumer Affairs Act and the Competition Act, both passed by Parliament late in 1994. Last year witnessed a reversal of this thinking, and now the two departments not merely fall within the same Ministry (which was not the case in the first years), but have also been merged > 52

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51 > administratively. They are headed by a Director who is responsible for these two departments now operating from the same office.

The Consumer Affairs Act had novel definitions of "consumer" and "trader" (S.2). These have been further developed and elaborated in the 2001 amendments. The Act adopted the position that a trader as such is not to be considered a consumer, a consumer being an individual who acquires goods or services for his private and domestic needs. The notion of "services" has now been defined for the first time. Professional and governmental agencies or para-statal bodies who provide services to private clients are now automatically subject to the Act.

The Act provided for the appointment of a Director of Consumer Affairs (S.3) – he is a government official appointed by the Prime Minister. He heads and manages the day-to-day running of the Department of Consumer Affairs, a unit forming an integral part of Government. The Department is responsible for the administration of this Act, as well as of the Trade Descriptions Act 1986, the Door to Door Salesmen Act 1987, (and, prior to 1996, the Weights and Measures Ordinance). As already explained, the same government official now also heads the department responsible for administering the Competition Act.

It also established the Consumer Affairs Council (S.4). This is principally an independent advisory and monitoring body. It debates policy matters and submits proposals to the Minister. It oversees the general position of consumers in Malta and the workings of consumer legislation, advises government and recommends legislative proposals and other matters, and plays a part in the issue of public warning statements. The Council is also been given the authority to register consumer associations for the purpose of the Act.

It regulates the issue of public warning statements which may be issued by the Director for the benefit of consumers particularly in relation to unsafe products or activities which may cause prejudice to consumers. The Director and the officials of the Department are exempted from civil and criminal liability, except where a statement is issued recklessly or in bad faith (S.8). This rule was originally introduced in the 1981 Act.

The Act provides for criminal vicarious responsibility to the extent that where an employee is found guilty of an offence against one of the designated consumer laws, the employer would be considered equally (S.10)

The Department is given formal authority to accept a written undertaking from an offending trader in lieu of commencing a criminal prosecution. This approach encourages voluntary compliance (S.12). It has been used sparingly and mainly in relation to the Trade Descriptions Act.

The award of "compensation orders" (equivalent to civil damages) has been made possible in criminal proceedings for offences against laws administered by the Director of Consumer Affairs. The presiding Magistrate may order a convicted defendant to pay to the complainant financial compensation up to Lm250 and moral damages up to Lm100. (S. 14).

It introduced the concept of moral damages into Maltese law. This constitutes one of the most significant innovations. Subject to some conditions and restrictions, the Act allows moral damages in both criminal and civil cases involving a consumer law element.

Another significant development which had been anticipated in the 1991 White Paper was the setting up a small claims tribunal with competence exclusively dedicated to consumer claims. The following represent the main features of this Consumer Claims Tribunal, which was established under Part III of the Act:

- claims up to Lm1500
- goods or services acquired by a consumer from a trader
- same day judgement where possible
- moral damages up to Lm100
- based on substantive justice and equity
- limited heads of appeal to Court of Appeal
- optional, non-exclusive competence

The Act created a new framework for the official recognition of voluntary associations committed to the protection of consumers (Part IV), thereby recognising their important role in consumer protection. The new rules replace those originally introduced in the Consumers Protection Act, 1981 which were largely discretionary and unsatisfactory. The salient features of the regulation of Consumer Associations under the Act are the following:

- 100 members minimum
- registered by Council
- objects restricted to consumer protection
- not profit-seeking
- exemption from liability
- elected committee
- independent from political parties and unions
- exempt from income tax

The Act repealed the Consumers Protection Act, 1981

The 1994 Act amended the Door to Door Salesmen Act, 1987 and excluded "insurance contracts" from its application, on the ground that the sale of such contracts were subjected to special regulation under the insurance law. The Act now applies to practically all services offered to consumers, on a doorstep basis, including other financial services. Professional services too are now subject to the Act for the first time.

The 1994 Act was amended in 1996 by the Malta Standardisation Authority Act, while in 2000 the Malta Standards Authority was established. As a result of these changes, responsibility for weights and measures passed to this newly established Authority. This Authority has also assumed the functions formerly carried out by the Malta Board of Standards and the Food Standards Board.

By virtue of the recent amendments, the scope of the Consumer Affairs Act has been amplified and strengthened. The Act has implemented a number of rules contained in several EU consumer directives. These include rules on product liability, unfair contract terms, misleading and comparative advertising, as well as administrative measures for the better enforcement of these rules.

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Another significant development which had been anticipated in the 1991 White Paper was the setting up a small claims tribunal with competence exclusively dedicated to consumer claims

52 > The competence of the Tribunal has been increased to Lm1,500 while the minimum number of members of a registered consumer association has been lowered to 100. For the first time, there is a declaration of fundamental consumer rights.

The Consumer Affairs Act, the Doorstep Contracts Act and the Trade Descriptions Act apply to financial services providers. Financial services are not excluded from the competence of the Department of Consumer Affairs or the Consumer Claims Tribunal. One should also be aware that new rules introduced in 2000 further control misleading advertising and prohibit pyramid schemes. When brought into force, the rules governing unfair contractual clauses and rules governing the giving of credit terms to consumers (not yet published), will be very relevant to financial services operators and will form an important and integral part of the legal framework in which they shall operate in the future. Insurance operators will want to examine closely the implications of the rules on the use of unfair terms in consumer contracts and the new liability provisions of the product liability rules and of the recent Product Safety Act.

Financial Services legislation

As the title of this paper has already indicated, we shall be focusing on the consumer of financial services. In fact, the consumer is today an important player, indeed a protagonist, in the constant development of the financial services industry, and the law has gradually recognised that it may no longer ignore or underestimate the significant part that he plays. In this sector the consumer is very often generally referred to as the investor, or as the depositor (in the case of banks), or as policy holder or insured person (in insurance).

Briefly, it remains one of the functions of the State to identify those areas of business activity warranting specific legislative intervention in view of the financial interest of the public in those areas, and because problems in such area may also carry disruptive social, economic and political consequences. Financial services constitute one such area. This sector is witness to the administration of people's money by other parties acting as financial intermediaries. Collective investment schemes, bank deposits and policies for life insurance are typical examples where ordinary people entrust part of their funds to be administered by others. A number of different and complementary laws create a comprehensive network of checks and controls that seek to establish an appropriate level of security for these investors.

Financial services legislation in Malta consists of a number of laws which have created a complex though relatively streamlined and coherent system which allows for the carrying on of relevant business for the operators in the sector while broadly guaranteeing adequate safeguards for investors. The promotion and encouragement of new business activities in the financial sector is regulated by recent laws which have introduced principles reflecting the best practice current in the area concerned, and one may safely claim that this has not been undertaken at the expense of the investor.

One can start to analyse the status of the financial services consumer in Maltese law by assessing the wide-reaching legislative changes introduced by Parliament during the past 20 years. These laws have significantly altered, indeed revolutionised, the legal landscape in which financial services law shall be carried on in the foreseeable future. None of these laws make any reference to the Consumer Affairs Act or any other consumer law. Nor does the Consumer Affairs Act contain relevant direct links to any of the financial services legislation.

One fundamental question shall provide a constant backdrop to this exercise: are the rights and legitimate expectations of the small private investor adequately protected by the ordinary civil and criminal laws, by the recent consumer legislation, or are they better safeguarded by specific regulatory laws which govern areas of financial services, provide for a licensing requirement and authorise the taking of administrative measures by statutorily established supervisory authorities?

Up to the end of 2001, a feature of the local structure of regulation in this sector was the presence of three distinct regulatory bodies

A Trinity of regulators

The modern approach to financial services regulation in Maltese law may only be traced to 1994, which may claim to be a historic turning point. This is due to the extensive legislation passed by Parliament during this period, laying the groundwork for further legislative changes currently envisaged for 2002.

Coupled with the parallel reforms in consumer protection law, the extensive measures adopted by Parliament since 1994 has radically changed the legal landscape in which financial, corporate and related services now operate. Perhaps the most important rule is that most financial intermediaries are now subject to some degree of supervision and to an authorisation requirement. Thus, for instance, 1994 saw the adoption of the Investment Services Act, a new Banking Act (which replaced the 1970 Act), and a Financial Institutions Act. Carrying out regulated activity without the proper licence is now a criminal offence. New legislation on insider dealing, money laundering and professional secrecy were also enacted in support of these primary laws, in an effort to keep the business clean and free from abuse.

Up to the end of 2001, a feature of the local structure of regulation in this sector was the presence of three distinct regulatory bodies, established under distinct legislation, with each body being allotted a particular area or sets of areas to supervise. These three bodies were in chronological order: the Central Bank of Malta, the Malta Financial Services Centre and the Malta Stock Exchange. This tripartite division of regulatory responsibilities is actually quite normal and mirrors the position existing in many other countries. Some countries have recently started moving away from this fragmented institutional arrangement preferring to concentrate all the supervisory functions in one single unified (three-in-one) agency. During these past two years, the Minister of Finance and a number of local newspaper reports have confirmed that government policy favoured the establishment of a single regulatory body wherein all regulatory responsibilities would be consolidated. From the consumer perspective, this should be a beneficial development as there shall only be one single point of reference reducing the possibility of uncertainty and of passing the buck.

With effect from 1 January 2002, by legal notices issued by the Minister of Finance in the Government gazette, all regulatory responsibilities under the Banking Act and the Financial Institutions Act, both of 1994, were transferred from the Central Bank to the MFSC. IQ

(This first part of the article has sought to highlight some salient features of our consumer legislation as recently amended, and to indicate a number of areas of direct interest to financial services providers. It has also introduced the financial regulatory authorities entrusted with administering the relevant laws. The second part of the article shall focus further on the actual financial services legislation and shall attempt to indicate a number of ways whereby these laws protect investors.)