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Investment Firms

Basic Operating Conditions under the Investment Services Directive (93/22/EEC), the Markets in Financial Instruments Directive (2004/39/EC) and other relevant legislation

Aggeliki Malaga

SCHOOL OF ECONOMICS, BUSINESS ADMINISTRATION & LEGAL STUDIES

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Student Name: Aggeliki Malaga

SID: 1104160022
Supervisor: Prof. Th. Papadopoulos

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Abstract

This dissertation was written as part of the LL.M in Transnational and European Commercial Law, Arbitration/Mediation and Energy Law at the International Hellenic University.

The dissertation offers a detailed commentary of the legislation concerning Investment Firms providing investment services and products and focuses on the prudential and operational requirements imposed by the Investment Services Directive (93/22/EEC), the Markets in Financial Instruments Directive (2004/39/EC) and other relevant legislation.

In particular, the dissertation addresses the following topics: (i) the Investment Services Directive, (ii) the Markets in Financial Instruments Directive ("MiFID"), (iii) the Markets in Financial Instruments Directive Level 2 (Dir. 2006/73/EC) and (iv) the Markets in Financial Instruments Directive II ("MiFID II"). Under each topic the most important obligations of Investment Firms will be discussed. The obligations concerning Authorization, Rules of Conduct, Investors Protection, Outsourcing and Transparency issues will be further analyzed. Moreover, this dissertation aims at underlining some of the developments in the operation of Investment Firms in last decades proving that legislation systems try to cope with modern Financial Market needs.

Keywords: ISD, MiFID I, MiFID II, Investment Firm.

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PREFACE

There is a general consensus that the establishment of a legal system involves restrictions and regulations, which could limit certain kinds of freedom. However, it should not escape our attention that a set of rules could form a protective environment. In particular, in the field of Investments, the establishment of a legal framework is of considerable importance and may affect positively the whole economic and financial system[1] and consequently the development of modern economy[2]. In the absence of a legal framework, and if the terms applied to investment agreements were freely imposed by the parties, it is virtually certain that the parties' unequal bargaining power would result in contractual imbalances[3]. The following Directives address a number of rules and requirements that relate to the organization and functioning of Investment Firms, especially with respect to the authorization of Investment Firms in the European Union, organizational requirements and investor protection issues. The necessity for the establishment of such legislation instruments can be illustrated if one considers the intrinsic link between the concept of investment and the concept of trust[4]. In order to understand the importance of this link more easily, the definition of Investment should be provided. According to a broad definition, investment *means "the consumption of goods today in order to achieve greater consumption in the future"*[5]*.* Based on a legal view of investment, there is a great need to create a connection between "*the forgoing of consumption today and the delivery of greater consumption in the future"*[6]*.*

[1] Frank B. Cross and Robert A. Prentice, 'Law and Corporate Finance' Edward Elgar (2007) 1.

[2] Emilios Avgouleas, 'Governance of Global Financial Markets: The law, the economics, the politics' Cambridge University Press (2012) 23,24.

[3] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 3, 19.

[4] Frank B. Cross and Robert A. Prentice, 'Law and Corporate Finance' Edward Elgar (2007) 28.

[5] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 3.

[6] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 3.

In fact, the field of investment businesses is trust-intensive[7]. This is due to the fact that investment belongs to a special category of long-term agreements and its performance is not simultaneous, but needs time to take effect. During this intervening period, which cannot be determined beforehand, the investor entrusts his funds to the Firm's control[8]. As a result, a great deal of trust is required and it could only be satisfied within a stable, legal framework.

Moreover, a rigorous monitoring system imposed by legal provisions would ensure more effective investors protection. Monitoring could be based on a mandatory disclosure of information concerning investments[9]. The imposed legal framework plays a crucial role in the monitoring and policing of financial activities. In this context, we shall try to analyze some of the most important provisions of Investment Services Directive (Directive 93/22/EEC), The Markets in Financial Instruments Directive (Directive 2004/39/EC) and The Markets in Financial Instruments Directive II (Directive 2006/73/EC) relating to Investment Firms and we shall focus on Investment Firms authorization in the European Union, organizational requirements and investor protection issues, especially under MiFID.

[7] Frank B. Cross and Robert A. Prentice, 'Law and Corporate Finance' Edward Elgar (2007) 28.

[8] Frank B. Cross and Robert A. Prentice, 'Law and Corporate Finance' Edward Elgar (2007) 31.

[9] Frank B. Cross and Robert A. Prentice, 'Law and Corporate Finance' Edward Elgar (2007) 53.

I. Introduction

In recent years, one of the main purposes of the European Commission, with the broad aim of a single market,[10] is the establishment of a common legal framework applicable to European Investment Firms and adapted to the challenges of the promoting of the economic and political harmonization in the Internal Market. This need for a common, modern and coherent legal framework was highlighted by innovative marketing mechanisms, especially these including cross border trade, which started to dominate in the Internal Market and with a view to the European Union to encourage investments by ensuring investor-effective protection. The implementation of a Community Directive was an absolutely essential objective for Investment Firms to cope with increasing competition, rapid technological advances, globalization and, more generally, the need for adaptation to continuously-changing markets. Confronted with this situation, the European Commission proposed a Directive for the first time in 1993 in order to enable access to financial services provided by distance and without limitations in the Internal Market.

On 10 May 1993, the European Commission, in order to implement the basic principles of the Treaty of Rome, especially the freedoms of establishment and the provision of services in the European Union in the field of investments, adopted the Investment Services Directive ("ISD") (Council Directive 93/22/EEC). With its implementation, ISD introduced the same principles in the field of Investment Services[11] by means of a set of detailed provisions (Art. 14-21 ISD). As analyzed below, perhaps the most important innovation of ISD, under a further harmonization effort,

[10] "*The Treaty on European Union (sometimes referred to as the Maastricht Treaty) entered into force on 1 November 1993. It created the European Union and amended and renamed the European Economic Community (EEC) Treaty (1958), which is now known as the European Community (EC) Treaty. Legislative measures relevant to the single market are adopted under powers contained in the EC Treaty. Hence, they are referred to in this book as EC measures and the single market is referred to as the EC single market. Moreover, the EC single market measures apply (sometimes with qualifications) to the broader area referred to as the European Economic Area (EEA).* Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 45.

[11] Emer Cashin, 'The Investment Services Directive: an overview' Journal of International Banking Law (1997) 148.

was the introduction of the idea of the "single passport" enabling Investment Firms to perform through branches or through cross-border trade throughout the European Union after granting authorization to a Member State[12]. The already established principles of minimum harmonization and mutual recognition paved the way for two basic principles established under ISD, the "single license" and "the home country control"[13]. However, the intensification of the association of national Financial Markets, the rapidly increasing use of electronic-based systems for the execution of client orders and the dissemination of new types of financial products that were previously unknown and unusual, highlighted the need for the replacement of ISD by a more effective legal instrument, adapted to the Integrated Financial Market[14].

The Investment Services Directive was replaced on April 21 by The Markets in Financial Instruments Directive (Directive 2004/39/EC)[15], which came into force and introduced substantive and procedural changes in legal and operational aspects of investment services and activities in Europe, especially by updated already known rules. The implementation of MiFID and the reform of certain aspects of the functioning of Investment Firms was, also, reflected in a gradual introduction of innovations especially in the structure of Financial Markets increasing competition between various stock exchanges. In fact, the MIF Directive revolutionized the framework of the financial regulatory business in the European Union by affecting not only investment services, but also the European Financial Markets. MiFID provisions present detailed organizational and functional measures which regulate cross-border trade issues and encourage the harmonization of EU financial and capital markets in

[12] Emer Cashin, 'The Investment Services Directive :an overview' Journal of International Banking Law (1997) 148.

[13] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 48.

[14] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 2,3.

[15] "Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ 2004 No. L145/1 ('MiFID'); and Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, OJ 2006 No. L241/26 ('MiFID Level 2 Directive')." Niamh Moloney , 'How to Protect Investors: Lessons from the EC and the UK' International Corporate Law and Financial Market Regulation' Cambridge University Press (2010) 199.

general. Among the analyzed provisions related to Investment Firms, (regulated Markets and other Institutions will not be examined under this paper) an object of particular attention will be investors protection. The rules of conduct and the avoidance of conflict of interest can be found in many provisions (art. 18-24 MiFID in particular), which cover a great part of the Directive and regulate in details the behavior of Investment Firms towards their clients[16].

II. The Investment Services Directive

1. Introduction

The Investment Services Directive (ISD) had been implemented by Member States by December 31, 1995, and applied to Investment Firms and to Credit Institutions, but only under very certain restrictions (Art.2 ISD). Despite its relatively limited scope, the ISD is a legislation of great importance because of the regulation of authorization of Investment Firms for the first time. The introduction of the "single license", analyzed below, gave rise to the recognition of the equivalence between Home State's[17] and Host State's[18] laws. As a result, the Directive resolved differences among Member States' law in the field of Investment Services and made the idea of a single Financial Market work[19]. According to article 3 of the Directive, authorization for Investment Firms falls under the responsibility of the competent authority[20] of the Home State. Also, the Directive left to the discretion of Home State the power to set out the minimum operating conditions and prudential rules to be complied by the Investment Firm to grant authorization. Authorization requirements are compulsory for all Investment Firms, irrespective of their turnover and volume of activities, and the

[16] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 2.

[17] Art. 1(6) ISD

[18] Art. 1(7) ISD

[19] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 48.

[20] Art. 1(8), 22 ISD

prudential supervision rules are also applicable to Firms with purely domestic business, which are required to fulfill all other requirements of art. 3 and 4 ISD[21].

2. Home and Host Member State

The concept of the Home and Host Member State is fundamental to the understanding of ISD provisions. The competent authorities of Home State and Host State play a supervisory role imposed by the ISD. The definition of "Home Member State" concerning Investment Firms is addressed in art 1 (6) ISD and it could be described as the Member State in which the head or the registered office (in cases of legal persons) is seated. At this point, it could be mentioned that, according to art.3(3) point 2, natural persons are able to fall under ISD, but under the specific condition that they can provide satisfactory Investor protection as adequate as that provided by a legal person[22]. The "Host Member State", according to art. 1(7), is the state in which the Investment Firm has established a branch or provides its investment services. In practice, one of the fundamental freedoms, which is ensured under ISD is the ability of an Investment Firm, once licensed in its Home State, to provide investment services and activities throughout the European Union, without the obligation to grant authorization to the Host State (also see TITLE V art. 14-21 ISD). On the other hand, the Host State authorities bear the responsibility for enforcing the conduct of business rules, imposed on Investment Firms which operate in the Host State's Market[23], as detailed below.

2.1. The responsibilities of the Home State - prudential requirements

The role of the Home State has significant value for a European Investment Firm or for the subsidiary of a non-EC business, which wish to establish a branch in any other

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[21] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 48.

[22] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 199-200.

[23] Emer Cashin, 'The Investment Services Directive: an overview' Journal of International Banking Law (1997) 148.

Member State. That is because the Home State applies the prudential rules, which every Investment Firm is required to fulfill in order to be granted authorization. The granting of authorization is a matter for home State to decide. In order for an Investment Firm to obtain the right to establish a branch in one or more EC States[24] the Firm must satisfy the requirements applied under TITLE II ISD.

In fact, art. 3 ISD sets the requirements, which should be met by an Investment Firm before granting authorization. The Home Member State is responsible for examining whether the conditions for authorization are satisfied. According to art. 3 (1), the Member State that provides authorization is obliged to specify the services which could be provided by the authorized Firm. These services must compulsory be mentioned in section A of the Annex of the Directive[25], in other words the Investment Firm should provide at least one core service in order to be granted authorization. As it is clearly mentioned under the same provision,[26] the authorized Firm could also provide non-core services, but these could not be their sole activity. Investment Firms providing only services described in section C of the Annex cannot be authorized under ISD. As a result, in cases of an Investment Firm asking for authorization under ISD, the Home State competent authorities have to apply community legislation and 'ensure' that the applicant Investment Firm carries out certain activities included in the catalogue of core services[27]. In particular, under art. 18 of ISD, *"Any investment firm wishing to carry on business within the territory of another Member State for the first time under the freedom to provide services shall communicate to the competent authorities of its home Member State the Member State in which it intends to operate*

[24] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[25] ANNEX SECTION A Services
1. (a) Reception and transmission, on behalf of investors, of orders in relation to one or more of the instruments listed in Section B.
(b) Execution of such orders other than for own account.
2. Dealing in any of the instruments listed in Section B for own account.
3. Managing portfolios of investments in accordance with mandates given by investors on a discriminatory, client-by-client basis where such portfolios include one or more of the instruments listed in Section B.
4. Underwriting in respect of issues of any of the instruments listed in Section B and/or the placing of such issues.

[26] Art. 3.1. ISD.

[27] Frank L. Fine, 'The liberalisation of Community investment services: a preliminary draft emerges' Journal of International Banking Law (1988) 278.

and a programme of operations[28] *stating in particular the investment service or services which it intends to provide"*. According to some opinions, Article 18 applies only to services actually provided in the Host State (that is a strict interpretation of "within"). If this interpretation prevails, then that would mean that postal, telephone or fax-based services from the Home State could not be regulated by the Directive. However, such an opinion could not remain abreast of rapid technological development and the need for the removal of internal frontiers. Under the Internal Market programme and harmonization efforts the locality of the provider of the Investment Service should not be taken into consideration. The preamble of the Directive also supports this less restrictive opinion[29].

Moreover, Art. 3 (2) is of particular relevance as it sets some restrictions on the right of the establishment and on the freedom to provide cross-border Investment Services, recognized in art 14 sub ISD. Despite the efforts of ISD to encourage cross-border trade, the risk of "letterbox companies" should be avoided through the restriction that Investment Firms which have a registered office have the obligation to have their head office in the same State and if they only have a head office (in cases where the national law does not impose a register office) this should be in the Member State in which the Firm asked for authorization[30].

In addition, according to art. 3(1) at the time of the application, one of the requirements that is evaluated is the applicant's financial resources and its capital adequacy, which should be taken into account on the basis of other factors, such as the range of activities of the applicant, its market risks and its position[31]. Investment Services Directive sets only a general obligation of initial sufficient capital. Other

[28] see also art 3.4 ISD.

[29] *" An investment firm authorised in its home Member State may carry on business throughout the Community by whatever means it deems appropriate; a Member State may not limit the right of investors habitually resident or established in that member state to avail themselves of any investment service provided by an investment firm covered by this Directive situated outside that Member State and acting outwith that Member State".*

[30] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[31] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 197.

Directives, including primarily technical rules, regulate specific economic data and other certain financial obligations. Such a Directive is 93/6/EEC, referred to art 3(3) ISD, which regulates the sufficient initial capital on a case by case basis. The ISD only sets a certain threshold of initial capital. This being so, each Member State exercise discretion and imposes stricter standards under the assumption of the principles of mutual recognition and proportionality in comparison to rules imposed in other Member States[32]. It should, also, be underlined that all the requirements imposed by art. 3(3) should be satisfied throughout the operating life of the Firm according to art. 8(1) ISD[33].

The Home State is also responsible for making inquiries into the good repute of the Investment Firm's directors (art.3(3) point 2). This requirement is associated with article 4, which imposes the notification of the identities of the shareholders or members of the applicant Firm in order to "*ensure the sound and prudent management of the Investment Firm[34]".* In fact, according to this article, the director is also required to be experienced to a satisfactory standard, which is evaluated ad hoc. The requirement of solid experience in the investment sector should be applied not only to the directors, but adopting a broad interpretation it should also be applied to owners and major shareholders of Investment Firms for example "those" representing at least 10 per cent of the capital or voting rights or exerting their significant influence on the company and corporate governance[35]. Other conditions, which are, also, evaluated for authorization are a detailed presented business plan and, in general, the capacity of the Firm to ask for authorization to comply with the laws of the Home State[36]. In addition, it should be mentioned that authorization granted at a certain moment may be withdrawn by Home State. For this purpose every Member State is

[32] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 197.

[33] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 197.

[34] Art. 4(2) ISD.

[35] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[36] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 198.

competent to comprise a dedicated authority, entrusted with certain tasks in the supervision not only of granting, but also of withdrawing of provided authorization, according to the detailed requirements of Art. 3(7).[37] In particular, Investment Firms are required to use the granted authorization in the time limit of twelve months and never cease their activities for a time period longer than six months or the authorization will be renounced. All the conditions analyzed above, including the adequate capital and the financial liability should be met throughout the use of authorization. If any one of these conditions ceases to apply the authorization may be withdrawn[38].

2.2. Non-EC Nationals obtaining authorization

The Directive generally applies to nationals of a European Union Member State. However, the Directive contains particular provisions applicable to non-EC nationals. The first one is art 5, which introduces the basic principle of equal treatment. According to this article, Member States should apply the same provisions to the branches of any Investment Firm, regardless of whether or not they have their registered office in a non-EU State. Investment Firms with a registered office seated in EU should not receive a special treatment. Moreover, Title III of the Directive (Relations with third countries) concerns Investment Firms that obtain their registered office outside the Community but wish to set up a branch in one or more Member States. According to this specific provision, an investment business registered in a non-European third country gains the opportunity to provide Investment services in Europe following the same authorization procedure, described above, without any further restriction[39]. These provisions are also applied to "*any person with its registered office outside the EC who intends in one or more member states to establish a subsidiary" and any "person with its registered office outside the EC who intends to acquire a*

[37] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[38] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[39] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 167.

qualifying participation in an existing investment business, or increase its participation so the business becomes a subsidiary"[40]. In all these cases mentioned, the non-European Investment Firm can apply and grant authorization to one or more Member States. The State ought to verify the validity of the request, transmit it and file a notification to the Commission and to all other Member States. After this part of the authorization procedure, described in detail under the provisions of Title III, the Commission examines the application concerning its substantive part and more notably examines if the investment business meets the reciprocal requirements to be granted authorization[41].

2.3. The responsibility of the Host State

On the other hand, under the ISD, the Host State mainly sets the conduct of business rules. This set of rules is based on general legal principles, especially on the principles provided under art. 11 ISD. It should, firstly, be underlined that the Directive provides general principles as a non-binding legislative tool, which act as a basis for a different set of rules imposed by each Member State. The most important of there principles are "*acting with due skill, care and diligence in the best interests both of the client and of the integrity of the market"* and "*adequate disclosure of material information to clients[42]."* Any Investment Firm operating in a Member State is bound by ISD to comply with the Host State's set of rules otherwise it risks losing the right to operate in this Member State[43].

3. The right of Establishment - The European Passport

The strict conditions under which an Investment firm can be granded authorization

[40] Art. 7(1) ISD.

[41] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 167.

[42] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 198-9.

[43] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 198-9.

have already been analyzed. However, the question is: why is authorization of an Investment Firms under the ISD so important? The most important privilege of authorization is the capacity of the authorized firm to provide certain services - listed in Section A and C of the Annex - in one or more Member State without any further authorization. This ability is described as the right of *Establishment* (also known as "European passport")[44]. The right of Establishment covers a restrictive variety of businesses. In particular, it applies exclusively to branches established in one or more Member States and it cannot be imposed on subsidiaries mutatis mutandis. However, it is important to mention that under the principles of mutual recognition and principles of equality, as stated above, the branch will be regulated by the Home State's prudential rules. At the same time the Host State is responsible for imposing rules of conduct, as will be analyzed below[45].

The right of free Establishment in one or more Member States clearly emerged as a vital need for the operation of the Internal Market under Modern Market conditions. Investment Services performed with the help of appropriate technological means can be offered across the community regardless of the location of the provider. The lack of physical presence, the opportunity of the investors to reach services provided in a European-wide framework and the need for the removal of trade barriers under the Internal market Programme imposed the introduction of the right of Establishment and the freedom to provide services in the field of Investment Services, recognized by articles 14-21 (Title V) ISD, which are applicable to all Investment Firms[46]. Transnational cooperation is necessary in order for these freedoms to be applied in a secure and efficient way. As a result, under ISD (art. 23,24), whether an investment business wishes to establish a branch or supply services in a Member State different from the home state in which it is authorized, the competent authorities of both the Home State and the Host State should be in a constant

[44] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[45] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[46] Marise Cremona, 'Legislative Comment: A European passport for investment services' Journal of Business Law (1994) 198-201.

communication and provide all detailed information about the Investment Firm's activities on its territory[47].

4. Rules of Conduct and General Good

So far, it has been discussed that the Investment Services Directive (ISD) recognizes the right of free Establishment of Financial Institutions throughout the Community imposing principles such as "single license" through the European passport and "home country control". However, these principles could not be free of restrictions. Art 11 of ISD provides the "general good" exception, which is an abstract concept lacking binding effect. However, in practice, this exception provision should apply in relation to the rules of conduct imposed and executed under the supervision of the Host State. These restrictions imposed by ISD should be interpreted in balance with each other. This opinion could be supported by art 18(2) ISD, according to which rules of conduct should be exercised under the principle of the 'general good'. This idea is broadened under the provision of art. 19(6), which also indicates that any rule of conduct can be imposed by the Host State provided that it is not in breach of the general principle of art 11[4849].

The interpretation and implementation of the principles analyzed above should also be examined consistently with the case-law of the EC Court of Justice on the free movement of services[50]. It has been submitted that if it was accepted that the Host State has the competence to apply conduct of business rules without restrictions, or if it was permitted to set restrictions applied only to foreign Investment Firms, this policy

[47] Simon Morris, 'Investment services draft directive: implications for financial service provision regulation in the UK' International Banking Law (1989) 166-7.

[48] Mads Andenas, 'Rules of conduct and the principle of subsidiarity' Company Lawyer (1994) 60, Jan Wouters, 'Rules of conduct: foreign investment firms and the ECJ's case-law on services' Company Lawyer (1993) 195.

[49] *"These principles are very similar to some of the principles laid down in the EC Commissions' European Code of Conduct Recommendation of 1977 (Recommendation 77/534/EEC of 25 July 1977, OJ 1977, L 212, 37). In the absence of EC harmonisation of rules of conduct, it is the responsibility of the Member State in which the service is provided to implement those principles and supervise the compliance there with (art 11(2) ISD)"* Jan Wouters, 'Rules of conduct: foreign investment firms and the ECJ's case-law on services' Company Lawyer (1993) 195.

[50] Case C-76/90, 'Sager v Dennemeyer' (1991), Case 120/78 'Cassis de Dijon' (1979), see, inter alia, judgment in Case 205/84, Commission v Germany, (1986) and in Case C-106/91, Ramrath, (1992).

must be regarded as a discriminatory behavior in favor of Internal National Markets, which is in breach of art 59 EEC. However, some restrictions could be imposed by a Member State but only under certain circumstances and proportionate to an objective of public interest and under the assumption that the same result could not be reached by less restrictive rules. Otherwise, even if the imposed controversial rules are justified by imperative public interest as for example by investor protection if they are in breach of the principle of proportionality, the Member State has the obligation not to apply them to the foreign Investment Firm[51]. According to these considerations, it has been obvious that because of the ambiguity during the interpretation of ISD's provisions, it should be interpreted in conjunction with the guidelines imposed by the Court of Justice case-law and the preferable interpretation should be the one which comes in conformity with the EEC Treaty[52].

5. Final thoughts

Taking into account the issues analyzed, it could be concluded that ISD opened up new horizons for Investment Services. Despite the uncertainty of some provisions particularly those concerning the rules of conduct issues, it goes without saying that the introduction of European passport and "home State control" under a stable pan-European legal framework created great opportunities for many European Investment Firms, which aimed to be extended beyond the borders of their local markets. Even if conduct of business rules had not be detailed imposed under ISD, the establishment of certain operational requirements and prudential supervision encouraged the participation of more Investment Firms in the field of the European Securities Industry and laid the foundation for subsequent legal instruments with more extensive and updated provisions[53].

[51] Jan Wouters, 'Rules of conduct: foreign investment firms and the ECJ's case-law on services' Company Lawyer (1993) 195.

[52] See, inter alia, judgment in Case 218/82, 'Commission v Council' (1983) and Cases 201/85 and 202/85, 'Klensch v Secretaire d'Etat' (1986)

[53] Emer Cashin, 'The Investment Services Directive: an overview' Journal of International Banking Law (1997) 152.

III. The Markets in Financial Instruments Directive ("MiFID")

1. Introduction

On January 31, 2007 the Markets in Financial Instruments Directive[54] ("MiFID") replaced the Investment Services Directive (ISD). The initial transposition deadline for the implementation of the new Directive was in April 2006 but it was postponed in order for Investment Firms falling under the updated Directive to have adequate time to adapt their operational system to the new rules. In addition, the Member States would need a sufficient time to adapt a revised national legal framework and adjust a supervisory system to the imposed provisions[55].

Under the new Directive, amendments have been made, especially in the field of Investors protection. As it has already been, mentioned, under ISD, the imposed rules of contact were based on general principles (art. 11 ISD), which were likely to be broadly interpreted. As a result, it was left to the Host State's discretion to determine the content of imposed rules of contact at the risk of discriminations against Foreign Investment Firms[56]. Moreover, according to this system, Investment Firms providing services in more than one Member States should, also, comply with a different set of rules in each Member State. This dysfunctional system required a radical overhaul for it to follow the idea of Harmonization[57].

The new Directive resolved this problem by introducing the "country of origin" approach[58], which complied with the idea of Harmonization in the Internal Market. According to this approach, the conduct of rules should be harmonized at a pan-European level and applied in all Member States under the same conditions. The new

[54] Dir 2004/39/EC [2004] OJ L145/1.

[55] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 2.

[56] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 31.

[57] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 32.

[58] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

Directive (Section 2, art. 19-24) imposed a set of rules containing specific business principles in order to ensure a non discriminatory investors protection[59].

In general terms, the aim behind the implementation and enforcement of MiFID was the abolition of the restrictions and obstacles in the cross-border trade of shares and investment services[60]. By that time, certain stock exchanges had the monopoly on Investment Services Securities as new Investment Firms and new customers were interested to engage in new Markets. As a result, the expansion of the players brought about a growing demand in the field of investment services, which in turn contributed to the increase of service supply. The increased demand in the Common Market encouraged competitiveness between multilateral trading facilities (MTFs) and Investment Firms and between exchanges and other trading platforms reinforcing the cross-border trade, forcing firms to be more productive in a more efficient way and competitive even at a global level[61].

This ever-changing situation highlighted the need for an updated legal framework fully aligned with the principles of minimum Harmonization and mutual recognition. Therefore, one of the most important objectives of the European Community was the establishment of a Single Market in the field of Financial Services by introducing the possibility for Investment Firms to act throughout the Community only by obtaining a single license and act under a comprehensive supervision according to the single passport rule[62]. The principles of "single license" and "home country control" were already known by Investment Services Directive, but they obtained real affect after the enforcement of Markets in Financial Instruments Directive[63]. Under this regime, investment firms obtaining a "single passport" are able to operate on a pan-European scale granting authorization only in their Home State. According to this plan and under

[59] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

[60] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

[61] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

[62] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 146.

[63] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 48.

the implementation of MiFID the development of investment activities was less complicated and much more efficient. In parallel, this situation created great opportunities for investors to have access to a greater number of investment products and enjoy high-level efficient protection[64].

2. Scope of MiFID- Scope of Authorization

According to art. 1 MiFID, the Directive applies to "*investment firms and regulated market"s (art.1.1) but also to "credit institutions and financial investment advisors (but only under restrictions and especially only when they advise on securities and they do not hold clients' funds or bonds) and other companies, which also fulfill certain criteria and acting as investors or as clients of investment service providers and financial networkers (art. 1.2)"*[65]. In fact, it is obvious that MiFID created a broader scope compared to ISD. In this paper, only the provisions that relate to Investment Firms will be discussed. The definition of Investment Firms is provided by art. 4(1) point 2, according to which *'Investment Firm' means any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis.* Investment Firms could also be natural persons who meet the requirements of art. 4(1) point 2, which ensure their integrity.

Despite the broad scope of MiFID a wide range of exemptions to its scope applies under Arts. 2 and 3. Some of these will be briefly analyzed. In particular, Article 2(1)(c) excludes persons who provide Investment Services incidentally during a professional activity when this activity is regulated. This activity could be regulated by legal provisions or professional code of ethics. In the same manner, according to Article 2(1)(j), investment advice provided by a person in paraller with another professional activity does not fall under the scope of MiFID. As a result, investment advice which is

[64] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 2.

[65] Jerome Herbet, Bernadette Nasser, 'Legislative Comment: The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 413.

provided accidentaly by accountants or legal professionals could be provided without MiFID-authorization, under the requirements of these specific provisions[66].

Investment Services falling under MiFID authorization scope could be divided into two categories. The first one includes core services also termed as Investment Services. According to the definition given in art. 4(2) point 1, core services are those listed in Section A of Annex I of the Directive *(including reception and transmission of orders in relation to one or more financial instruments, the exploitation of multilateral trading facilities execution of orders on behalf of clients or investment advice, research in investment and financial analysis money-market instruments or units in collective investment undertakings, new derivative financial instruments (including derivative contracts relating to commodities, or to geological, environmental or other physical variables[67])*. The other category includes non-core services, also known as "ancillary service" which are defined under art. 4(3) MiFID[68]. According to art.6, every Investment Firm applying for authorization should provide at least one core service. This is a prerequisite for the acquisition of a European passport, as explained below. The solely provision of ancillary services by an Investment Firm is not enough for the granting of authorization under MiFID[69].

In light of the above it is obvious that services and instruments regulated by the new directive are expanded and updated in comparison with ISD scope. At this point, and because of its great importance in the field of Investment Services provided by

[66] Niamh Moloney , 'How to Protect Investors :Lessons from the EC and the UK' International Corporate Law and Financial Market Regulation' Cambridge University Press (2010) 202,3.

[67] Jerome Herbet, Bernadette Nasser, 'Legislative Comment :The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 413.

[68] *Ancillary services (1) Safekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management; (2) Granting credits or loans to an investor to allow him to carry out a transaction in one or more financial instruments, where the firm granting the credit or loan is involved in the transaction; (3) Advice to undertakings on capital structure, industrial strategy and related matters and advice and services relating to mergers and the purchase of undertakings; (4) Foreign exchange services where these are connected to the provision of investment services; (5) Investment research and financial analysis or other forms of general recommendation relating to transactions in financial instruments; (6) Services related to underwriting. (7) Investment services and activities as well as ancillary services of the type included under Section A or B of Annex 1 related to the underlying of the derivatives included under Section C – 5, 6, 7 and 10 - where these are connected to the provision of investment or ancillary services.*

[69] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 5.

Investment Firms, we will discuss a key 'service', which has been recognized by MiFID as a core investment service for the first time.

2.1. Investment advice

At this point, a wide analysis of activities falling under the scope of MiFID authorization would be unnecessary. However, it is worth giving a greater focus on the definition of investment advice. As mentioned, the inclusion of investment advice under the scope of authorization of a Directive was a novelty of MiFID[70]. The investment advice had already been regulated by ISD, but it was "upgraded" by the new Directive. Under ISD, investment advice was listed as a non-core service. As a result Investment Firms providing investment advice were not in any position to ensure passport rights if it did not provide core services in parallel. MiFID introduced a great innovation recognizing investment advice as a regulated activity able to ensure the benefit of granting authorization for Investment Firms with no other core activities[71].

In particular, art. 4(4) of MiFID provides the definition of investment advice. According to this provision, investment advice is the activity " *of a personal recommendation to a client either upon the client's request or at the initiative of the firm in respect of one or more transactions relating to financial instruments"*. The concept of recommendation under art. 4(4) includes a recommendation for financial transaction, for instance, buy, sell, subscribe to or exchange and in general contains any exercise of any right concerning a particular financial instrument. The requirement of personal character of recommendation also has great importance because recommendations concerning the public in general cannot be regarded as a personal recommendation and does not meet the requirements to be defined as investment advice[72].

[70] Niamh Moloney , 'How to Protect Investors :Lessons from the EC and the UK' International Corporate Law and Financial Market Regulation' Cambridge University Press (2010) 203.

[71] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 5.

[72] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 5.

The definition of an activity as investment advice is not only a theoretical issue but it assumes practical implication because it is connected with specific obligations imposed by MiFID only on Firms providing specific services concerning advice or portfolio management. Art. 19(4) states that firms providing investment advice are also obliged to ensure that it has all the "know-your-customer" information. This information concerns the customer's knowledge and experience in the field of investments, their financial capacity and their investment objectives. The gathering of information is crucial for Investment Firms in order to recommend to their clients services and instruments capable of meeting their needs and their objectives[73].

3. Authorization and Prudential requirements

The concept of a single passport had already been introduced by ISD. However, the meaning of a single passport is updated under MiFI Directive. As we have already mentioned, in Annex I, section A of the MiF Directive there is an upgraded list which includes services and financial instruments, which meet the demands of Modern Markets. A prominent example of these efforts of modernization is the addition of investment advice under the protective regime of MiFID. This addition in conjunction with the introduction of an expanded set of rules of high-level investor protection came into force in order to fill the gaps of ISD, which could not stay efficient in plenty areas and could not cope with the rapid changes in the field of Financial Market and in particular the field of investments. The "passport" system was not working well enough. It had to be updated in order to eliminate barriers to cross-border trading and so inject fresh competition into the European Investment Services Industry, as mentioned above. This effort of modernization could not succeed if it was not combined with an investor's protective legal framework[74]. Efficient protection is an important prerequisite for EU Capital markets to attract new investors.

The concept of granting authorization by the "Home State" and the idea of a "single passport" were already known by ISD. MiFID maintained the general principles

[73] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 3-5.

[74] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 2.

introduced by ISD. European Passport and Market Integration are supported by article 5 concerning authorization and articles 6-12 including supporting rules. According to the single passport concept, article 6(3) states that "*the authorisation shall be valid for the entire Community and shall allow an investment firm to provide the services or perform the activities, for which it has been authorised, throughout the Community, either through the establishment of a branch or the free provision of services*". In other words the Investment Firm, which was granted authorization in its home State is able to provide Investment Services in any other European Member State, where it wishes to provide such services or activities and it has no obligation to grant new authorization in this Member State[75]. Apart from these rules imposed under the concept of authorization the Directive supports the operation of a protecting and monitoring system by imposing perimeter controls on intermediation. Article 12 introduces one of these perimeter requirements by imposing initial capital requirements[76]. It is necessary to mention that the soundness of the Investment Firm is extremely important for the success of the Investment Service provided because of the intrinsic link between the concept of investment and the concept of trust, mentioned in the preface of this paper. As it has already been explained the retail customer lacks the necessary experience to monitor and evaluate the financial reliability and the soundness of the investment firm he trusts. As a rule, the customer puts his confidence in the firm and he trusts his funds by the time he enjoys the fruits of his investment. The monitoring of the solvency and conduct of business of the Investment Firms is left to competent authority responsibility[77]. In the same chapter (Chapter I: conditions and procedures for authorization) MiFID also demands management requirements (art.9), programme of operations (art.7) and shareholders review requirements (art.10) which are introduced in order to ensure stability in the operation of the firm and to boost its ability to cope with risk events. More specifically,

[75] Jerome Herbet, Bernadette Nasser, 'Legislative Comment :The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 414-415.

[76] The capital adequacy requirements imposed on investment firms are governed by the 2006 Capital Requirements Directive which is composed of Directive 2006/48/EC, OJ 2006 No. L177/1 and Directive 2006/49/EC, OJ 2006 No. L177/201.

[77] Howard Davies, David Green, 'Global Financial Regulation: The essential guide' Polity (2008) 23.

prudential rules are also particularly significant for Asset Management Services where assets are transferred to the Investment Firm[78].

4.Organisational requirements

Article 13 MiFID imposes various organisational requirements including compliance of the firm to the provisions of the Directive, disclosure of conflict of interest (13.3), continuity and regularity in the performance of the Investment Firm (13.4), outsourcing and risk assessment (13.5), record keeping (13.6), adequate arrangements to safeguard consumers' belongings and funds (13.7,8). The Home State bares the responsibility for the compliance of the firms with the organizational rules. Article 13(2) of MiFID imposes on the firm a specific obligation to establish adequate policies and procedures sufficient to ensure compliance with provisions under MiFID[79]. In particular, art 13 (2) obliges the firm to ensure compliance with all imposed provisions and maintain this permanently and effectively throughout its operation. Under these implementing measures Investment Firms are required to perform a compliance function offering access to the necessary authority and resources, and in general to all relevant information. Senior managers should also take a detailed report about this compliance function. In addition, it is obvious that persons responsible for the monitoring of the compliance function should have no connection with the services or activities that they check under the principle of personal independence. At this point it would be useful to mention that even though these obligations are imposed in every investment firm fallen under MiFID without exception, in practice they best reflect large firms[80]. In the future it would be efficient for small firms to be required to keep procedures that would be appropriate for the volume and the nature of the activities and services provided by them.

4.1. Conflicts of interest - Investment research

[78] Niamh Moloney, 'How to Protect Investors :Lessons from the EC and the UK' International Corporate Law and Financial Market Regulation' Cambridge University Press (2010) 208.

[79] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 7-9.

[80] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 7-9.

The obligation of Investment Firms to avoid prejudicial conflicts of interest is imposed by Article 18(1) MiFID, which introduces the principle of fair treatment among firm's clients during provision of any investment service. Moreover, conflict of interest is also regulated under the regime of best execution and order handling, which will be analyzed in detail below. In fact, the conflict of interest concept has been one of the cornerstones of MiFID, which provides a set of relevant provisions (Articles 13(3) and 18)[81].

According to article 13(3) MiFID Investment Firms are required to *"maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps to prevent conflicts from adversely effecting the interests of their clients"*. The obligations imposed by Article 13 of the Directive should be interpreted in conjunction with article 18. In particular, article 18(1) provides that "*Member States shall require investment firms to take all reasonable steps to identify conflicts of interest between themselves including their managers, employees and tied agents or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and ancillary services or combinations thereof*". However, the Commission acknowledges that under certain circumstances the risk of conflict of interest cannot be avoided, despite the firm's efforts. For these cases article 18(2) states that in cases under which, despite the existence of organisational or administrative arrangements, the risk of a client's damage cannot be prevented, the investment Firms are obligated to inform the client of any conflict of interest involving him, before acting on his behalf[82].

The conflict of Interest Management could include some specific organisational or administrative arrangements. Here there are some examples. First of all analysts and other members of staff should not have a personal account. Moreover, these persons and every person, who is involved in the production of investment research should not

[81] Niamh Moloney, 'How to Protect Investors :Lessons from the EC and the UK' International Corporate Law and Financial Market Regulation' Cambridge University Press (2010) 232,247.

[82] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 14.

accept any material inducement by issuers and should have no material interest. In the same way of thinking they should also not promise issuers any favorable behavior against other clients like, for example, a beneficial research coverage. In addition, the research report should be handled with the greatest discretion, meaning that no person with a potential material interest should have an access to the included data or to a review of the draft[83].

In fact, every Investment Firm is obligated to have an effective conflict of interest management and an unambiguous and determined policy, in conformity with its size and nature and the nature, complexity and special characteristics of the activities and services provided. This policy should also be in writing in order to ensure its transparency and stability. It should also be mentioned that if the firm belongs to a larger group of companies, it should be examined as such, and it should adopt a certain policy taking into consideration this special circumstance. In these cases, the conflict of interest policy should also be established taking into account the structure and business activities of the other members of the group[84].

4.2. Outsourcing

The idea of outsourcing was firstly introduced by MiFID, but it underwent great development after the implementation of the new Directive MiFID Level 2, especially with the introduction of detailed provisions in arts 13-15 MiFID Level 2 Directive, as detailed below. Directive 2004/39 recognizes outsourcing as an organizational requirement. In particular, article 13(5) MiFID states that if the Directive the Investment Firm which cooperate with a third party for the performance of operational functions or investment activities on a continuous and satisfactory basis, is responsible to take any measure for the avoidance of additional risks. *"Outsourcing of operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the firm's regulator to monitor the firm's*

[83] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 14-15.

[84] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 14.

compliance with relevant obligations". To put it another way, an Investment Firm, while providing its services through a third party, should ensure, that the third party has adopted all the measures necessary to avoid operational risks in a continuous and satisfactory way[85].

Under MiFID, the Investments Firm and its managers bear the responsibility for all outsourced services. With this responsibility not only firms but also the cooperating third party shall exercise "*due skill, care and diligence"* in the selection of managing and the review of services providied and fulfill every operational function during their activities. In practice, the firm has the obligation to examine the relevance and the sufficiency of the supplier, who carries out the investment services, to exercise efficient supervision over him according to the application of all outsourced functions and relevant risks and ensure that the provided services meet all the requirements imposed by the applicable law[86].

Outsourcing is regarded as an operational function and therefore it is a pre-condition for the firm's authorization. As a result, it is very important to be performed throughout the life of the investment firm[87].

5. Investor Protection

One of the cornerstones of MiFID was the establishment of a stable investor-protective framework. Section 2 includes specific provisions regulating, inter alia, the firm's conduct of business obligations (art. 19), best execution of orders (art.21) and client order handling rules (art. 22). This set of rules, analyzed below, ensures a high level of protection and makes MiFID the first efficiently investor-friendly Directive. In practice, the content of these rules was based on pre-existing professional codes and

[85] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 146.

[86] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 146.

[87] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06), 7.

established standards in the financial market[88]. However, MiFID succeeded in adjusting these rules to a modern framework influenced by the Single Market imperatives.

5.1. Segmentation of the Clients

The new Directive emphasizes the operation of Financial Market, justifying the name given by the Commission[89]. A centralized Market was regarded as the best way to organize securities and investment trading. With the need for new markets and the interest of more investment firms and new consumers involved, the Commission had the obligation to impose a certain conduct of business throughout the Community. Under the new provisions, firms were obliged to categorize their clients based on certain criteria and according to this classification to provide services "suitable" or "appropriate" for each client according to his needs and under the principle of the best execution with the best balance of price and quality. This protective framework was of great importance, especially for retail investors, who used to be at a particular disadvantage compared to the Investment Firms because of their limited bargaining power[90]. Moreover, it is a matter of common knowledge that an investor's financial situation is closely coordinated with the costs and returns of his financial transactions. To put it differently, a prominent customer, whether a borrower or an investor, is in an advantageous position and accesses the Market more efficiently than a small one, who needs extra legal protection[91].

According to MiFID provisions clients of Investment Firms can be separated into "professional clients" (art. 4(11) MiFID), "eligible counterparties" and "retail clients" (art. 4(12) MiFID). The title of *Professional clients* is appropriate for experienced, knowledgeable and well-informed consumers, who have the ability to evaluate and bare their own risks and as a result require limited protection. MiFID automatically

[88] Jerome Herbet, Bernadette Nasser, 'Legislative Comment: The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 416.

[89] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

[90] 'Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

[91] Beate Reszat, 'European Financial Systems in the Global Economy' John Wiley & Sons (2005) 16.

classifies these clients as professionals. Moreover, the Directive provides Annex II, which includes all the categories of clients, who are considered to be professionals. This category includes "*credit institutions, investment firms, other financial institutions, insurance companies, collective investment schemes and their management companies, pension funds and their management companies, commodity and commodity derivative dealers, major companies (fulfilling certain threshold criteria) and other institutional investors,"*[92] who are authorized or regulated entities. *Eligible counterparties's (ECP*) transactions are separately regulated by article 24 MiFID. They operate on Capital Markets and, as a result, these clients are considered to be the most well-informed investors. According to article 24(2) MiFID this category includes *"investment firms, insurance companies, UCITS and their management companies, pension funds and their management companies, regulated financial institutions, national governments and their services, including public organizations in charge of managing the national debt, central banks and supranational organizations"*[93]*.* The category of *non-professional clients* includes retail clients, who are considered to be in a less advantageous position and as a result they need a more effective and completed protective framework, which includes specific rules of good conduct[94]. Clients in this category have at their disposal a widder variety of provided investment services and products such as equities or bonds. These non-professional investors decide to make an investment just in order to increase their savings as much as possible. In order to achieve this aim they are free to choose any investment service supplied by a domestic or a foreign provider, without any difference, as under MiFID the level of protection never differs. Moreover, for these clients, the cost of the services has a great value because their aim is the increase of their savings and, as a result, the balance between quality and price is of great importance. Concerning this category of clients, the Investment Firm also bears the responsibility to provide all useful information concerning the recommended investment. However, because of

[92] Jerome Herbet, Bernadette Nasser, 'Legislative Comment :The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 415.

[93] Jerome Herbet, Bernadette Nasser, 'Legislative Comment :The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 415.

[94] Jerome Herbet, Bernadette Nasser, 'Legislative Comment :The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 416.

their lack of experience, it is important for the provided information to be limited to whatever, which could be useful to the clients and not to inundate them with irrelevant and confusing information, which they cannot understand and evaluate. In addition, the Investment Firm is required to inform retail clients fully about the firm's obligations in order for clients to know their rights and request an appropriate behavior. Moreover, the information concerning its clients and their experience and any other information that could be useful should be selected at the firm's responsibility to provide their client "suitable" or "appropriate" products and services[95].

Despite the obligation of Investment Firms to separate their clients into categories and inform them of the category they belong in, clients have the opportunity to alter their category and ensure a different level of protection. The capacity of category change is based on criteria such us the volume of the client's transactions per year. Clients are allowed to request to be removed from one category to another for all the provided services or only for specific types of products or transactions. Under the regime of this opportunity, non-professional clients can "opt out" (art. 24(2) point 2) meaning that under specific procedures and criteria, they can ask for a less protective regulation. On the other hand, clients who belong in other categories have the opportunity to "opt in" for certain activities in order to gain a higher level of protection (Annex II, second topic). According to the regulated procedure, the client concerned expresses his will to change his classification. However, the final decision is at the Investment firm's discretion. In any case, if an Investment Firm rejects a client's request for category alteration, the client is allowed to address the same request to another firm, which could agree to provide him with the desired level of protection[96].

5.2. Conduct of business obligations: provided information and suitability test

[95] Legislative Comment: MiFID enters into force' EU Focus (2007) 221, 3.

[96] Jerome Herbet, Bernadette Nasser, 'Legislative Comment: The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 416.

Article 19 MiFID imposes a set of conduct of business obligations and requires Member States to ensure that Investment Firms provide services in compliance with investor protection. Under this topic, the most important of these obligations will be discussed. According to art 19(1) MiFID, the Investment Firm is obliged to *act "honestly, fairly and professionally in accordance with the best interest of its client*". This specific provision will be understood better analyzed in conjunction with the following provision. So, as mentioned in previous topic, article 19(2) requires all investment firms to provide "*fair, clear and not misleading"* information. Article 19(3) introduces the term of *"Appropriate information",* which is defined as the information which is provided *"in a comprehensible form concerning the firm and its services, the instruments which be used and proposed investment strategies, execution venues, cost and associated charges*[97]. As mentioned above, the firm should provide only useful information and not inundate its clients with irrelevant and confusing information which cannot be understood and evaluated[98]. Paragraph 3 also underlines the Firm's obligation to enable the investor to realize the nature and the risk of his investment. As analyzed in the preface, the concept of risk plays a crucial role in the field of investments, so a reference to its importance should not be omitted from this section.

The obligation of a suitability test is introduced in the next two paragraphs (19(4), 19(5)). According to this obligation, the Investment firm bears the responsibility of collecting certain information about the client concerned. This information is relevant to the client's knowledge and experience, his perspectives and his financial situation and varies according to the nature of the product or service required[99]. In particular, the Investment Firm should examine in security before the transaction that the provided service or advice meets the client's investment aims, he is able to bear the financial risk in order to fulfill his objectives and he has the experience and knowledge to realize the actual size of the risk taken[100]. For information about the client's knowledge or experience, the firm could refer to previous services and transactions in

[97] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 11.

[98] Legislative Comment: MiFID enters into force, EU Focus,2007, EU Focus 2007, 221, 3.

[99] Jerome Herbet, Bernadette Nasser, 'Legislative Comment: The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 417.

[100] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 11.

which he had been involved in the past or to financial instruments he may have used. The most important elements are the nature, volume and frequency of the transactions. Other useful information could be the client's profession, his social environment and in general his educational level[101]. The firm should take into consideration all the information selected at its responsibility and recommend the specific type of service or product which would be more suitable for the client's needs and objectives[102]. The client's financial situation can easily be examined as the firm has the means to collect this information through searching the extent of his regular income, his financial commitments under a regulate basis, his liabilities and his assets including liquid assets, or other kinds of property, either investments or real[103]. In addition, based on the information provided the firm is bound to examine the required service to see if it is applicable to the client in question. In any case, if the necessary information cannot be selected for any reason, the firm is not able to apply the suitability test. As the appropriateness of the provided services cannot be examined the firm is obliged to inform the client that the required services cannot be offered[104].

Conduct of business regime, imposed by article 19 and its extensive level 2 rules, established an investor protection code based on the foundation of fair treatment obligation, generally accepted marketing rules and know-your-client requirements[105]. Apart from these general obligations of fair treatment and conduct of business imposed under the provisions of article 19, MiFID also includes obligations concerning transparency and integrity (art. 25-30), which also contribute to the facilitation of compliance monitoring of firms operation by competent authorities. The establishment of these provisions results indirectly in investors protection, ensuring

[101] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 12.

[102] Jerome Herbet, Bernadette Nasser, 'Legislative Comment: The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 417.

[103] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 12.

[104] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 12.

[105] Niamh Moloney, 'How to Protect Investors :Lessons from the EC and the UK' International Corporate Law and Financial Market Regulation' Cambridge University Press (2010) 208.

that authorized Investment Firms meet all the requirement to provide services and products in a stable and reliable environment.

5.3. The Rule of "Best Execution"

The rule of Best Execution can be described as the obligation of the Investment Firm to "*take all reasonable steps to obtain the best possible results for their clients*" as it is described under αrticle 21 MiFID. Before the execution of any order and before the provision of any activity to the client, the Investment Firm should take into consideration certain factors that would ensure the best execution of the service provided. These factors could be costs, speed and likelihood of execution, settlement, size and nature of the execution and in general any other considerations that could affect the execution of the order and the clients' investment choices[106]. In cases in which the order is executed outside a regulated market or MTF, the firm has the obligation to ask for a prior express consent of the client, according to art. 21(3). This consent can be given particularly for a certain transaction or could be provided in general within the framework of cooperation between the firm and the client[107]. In order to achieve the "best execution" the Investment Firm should use certain execution venues suitable for each client's order, provide him with a list of the available venues[108] and evaluate effectively all the relevant factors[109]. Because of the inexperience of the client, the Investment Firm bears the responsibility of ensuring him that the selected venue is the most efficient for the execution of each order.

In order to examine whether or not an order execution is the "best", it is also important to check the time limit in which it was performed. The order execution should be performed rapidly in order to become known publicly and be accessible to a

[106] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 3.

[107] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 13.

[108] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 13.

[109] Richard Stones, 'Conduct of business: an update' Compliance Officer Bulletin (2006) 34.

wide range of market participants as soon as possible[110]. However, it should not escape our attention that the execution of the order should always be examined in conjunction with instructions that may have been provided by the client. If the client has already suggested the way according to which he wishes his order to be executed, the Investment Firm is obliged to follow the specific instructions. If the firm acts in compliance with these instructions, it is considered to have given "best execution", even if there were more beneficial alternatives. However, this exception will apply on condition that the firm provided the client with a clear and prominent warning of any potential risk[111].

The responsibility of the Investment Firm, under the "best execution" regime, is neither absolute nor unquestionable. According to MiFID, the firm has the obligation to take all reasonable steps, evaluate the provided information and recommend investment products and services in the best interest of the client in a prompt, fair and expeditious way. However, the firm is not responsible for the client's final decisions, provided that he was fully informed about all the aspects of his investment. In addition, every investment involves the element of risk and as a result there is always the possibility that may it not return the expected profits. In this case, and provided that investor was informed about any potential risk, the firm bares no responsibility. To put it differently, firms should only be required to do what is reasonable[112].

5.4. Client Order Handling Rules

The obligation of Investment Firms to avoid discrimination in the handling of clients' orders is imposed by article 22 MiFID. In accordance with the "best execution" regime, analyzed above, article 22 introduces the rule of "*prompt, fair and expeditious execution*" of client's orders that the investment firm has at its response, relative to

[110] Richard Stones, 'Conduct of business: an update' Compliance Officer Bulletin (2006) 35.

[111] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 13.

[112] Arun Srivastava, Elliot Shear, 'EU securities and markets review' Compliance Officer Bulletin (2005/06) 14.

other orders or its trading interest[113]. In order for an execution to be considered as fair and non-discriminatory it alleges that clients' orders should be executed on a first-come, first-served basis[114]. However, in this aspect it is important to identify the relevant moment for determining which order "came first". In the view of the writer, the crucial time is the time at which the order was expressed to the investment firm as a final decision. The prior time period for information gathering, making recommendations and discussions is irrelevant. Moreover, the handling of the client order should be carried out with high standard, regardless of the place or the way (natural occurrence or at a distance with the use of technological instruments) and in compliance with the conflict-of-interest rules, also imposed by MiFID.

6. Transparency requirements

Section 3 MiFID deals with the issue of market transparency and integrity. In the Commission's efforts to achieve the functioning of an efficient and effective monitoring system, the new Directive introduces some transparency and integrity requirements imposed by articles 25-30. Article 25 addresses the Member State's obligation to ensure certain measures in order to enable competent authorities to monitor the Investment Firms' activities[115]. For more effective monitoring, article 25.2 introduces the obligation of data recording. According to this, Investment Firms are obligated to "*keep at the disposal of the competent authority, for a minimum of five years, the relevant data relating to all financial instrument transactions they have carried out, whether on their own account or on behalf of a client*". The recorded data should concern every transaction, regardless of its volume, nature or method of performance. If the recorded transaction has been executed on behalf of a client, all the information concerning him should, also, be provided in detail. Record-keeping obligation is subject to stricter requirements when the investment firms are admitted to trading in a regulated Market or a MTF. For example, according to article 25(3)

[113] Richard Stones, 'Conduct of business: an update' Compliance Officer Bulletin (2006) 35.

[114] Jerome Herbet, Bernadette Nasser, 'Legislative Comment :The MiF Directive, the next regulatory quake in the area of European financial law' International Business Law Journal (2007) 418.

[115] Legislative Comment: MiFID enters into force, EU Focus (2007) 221, 3.

MiFID the firm is obliged to report details of any transaction by means of any financial instrument and maintain certain procedures enabling their monitoring. The information which should be made public mainly concerns the volume and the price of the executed transactions and the exact time that they were concluded. In addition, according to art. 28, it is the special obligation of Investment Firms trading in a regulated Market or an MTF to make information public *as close to real-time as possible, on a reasonable commercial basis, and in a manner which is easily accessible to other market participants* (post-trade transparency art. 28)[116]. Despite the fact that the transparency obligation will not be further analyzed under this paper, the imposed legal framework concerning transparency imposes a detailed set of rules, requirements and procedures that play a crucial role in the monitoring and policing of financial activities by competent authorities and is worthy of consideration.

7. Freedoms of Investment Firms

The fundamental freedoms for the functioning of Investment Firms and their value have already been analyzed under previous topics. Because of their importance, these freedoms had already been recognized by earlier legislation. In particular, the freedom to provide Investment Services has it roots in the Treaty on European Union, which entered into force on 1 November 1993[117]. The same freedom was, firstly, introduced in the field of Investment Services by ISD. In particular, the freedom of investment firms to provide investment services and activities is recognized by article 31 MiFID, and the right of Establishment of a branch is recognized by article 32. It is obvious that the Commission attributed explicitly these rights remaining bound to its aim of a Single Market (Internal Market) in the Community. In fact, freedom to provide services differs from the freedom of Establishment to the point where the second kind ensures the right to provide services in another Member State, not only simultaneously, but on a temporary basis, through a permanent Establishment in this Host State. However, freedom of services should be imposed under certain restrictions and only under the

[116] Pierre Schammo, 'EU Prospectus Law: New Perspectives on Regulatory Competition in Securities Markets' Cambridge University Press (2011) 51.

[117] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 45.

control of the Member State in which it is provided[118]. These general terms of freedom are also met in the Treaty on the Functioning of the European Union (2007) and have outstanding significance for the organization and functioning of the Internal Market. Typical examples are the right of "Freedom to provide services", recognized by art 56 TFEU (ex art. 49 TEC), and "Freedom of establishment", recognized by art 49 TFEU (ex art. 43 TEC).

IV. The Markets in Financial Instruments Directive Level 2 (Dir. 2006/73/EC)

1. General Overview

In September 2006 the MiFID Lever 2 Directive was official by published by the European Parliament. It introduced twelve new provisions, of which their major part specified technical measures concerning already imposed requirements and procedures. For the detailed description of the organizational requirements, MiFID Level 2 provided a set of articles (art 5-25), which replaced articles 13.2-8 MiFID Level 1. Level 2 Directive focused, especially on outsourcing (art. 7, art., 8 art. 13, art. 14 and art.15), which had already been regulated in general by art 13.5 MiFID Level 1. In addition, MIFID Level 2 Directive focused on the conflict of interest concept, providing operating conditions in articles 26-43 and 44-46. In fact, Level 2 significantly included operational requirement concerning the structure of the Financial Market in the field of investments, reporting and monitoring requirements and supervision and governance by the Home State's competent authorities.

At this point, we will refer to some of the provisions of the most practical importance for the operation of Investment Firms. The organizational risk management regime (Article 13) has been replaced by Level 2 Directive, which covers decision-making, internal controls and risk management, employee competence, internal reporting,

[118] Iain MacNeil, 'An Introduction to the Law on Financial Investment' Hart Publidhing (2005) 47-48.

record-keeping, data protection, business continuity, accounting and monitoring (Article 5), and senior management responsibility (Article 9). Moreover, compliance is addressed in Article 6 and risk management is referred to in Article 7. Article 8 regulated internal audit functions and article 51 analyzed record-keeping obligations. Level 2 Directive also regulated the outsourcing of 'critical or important operational functions' in Articles 13–15). An extensive asset-protection regime applies under Articles 16–20 and reflects the MiFID Article 13(7) and (8) the obligation to maintain asset and money protection systems. These prudential rules have important implications for investor protection by supporting the stability of the firm. These detailed described prudential requirements, also, play a crucial role in the Investment Firm to ensure that it remains sustainable[119]. Level 2 Directive, also, provides a set of rules (articles 44-46) regulating the "best execution" concept, which has already been analyzed above[120].

2. Outsourcing under the MiFID Level 2 Directive

The idea of outsourcing had already been introduced by MIFID Level 1 Directive, but it had a great development after the implementation of Level 2, especially with the introduction of detailed provisions in articles 13-15. Directive 2004/39 recognizes outsourcing as an organizational requirement. The outsourcing concept was addressed in art. 13(5) of the Directive, but because of the short and general wording of the provision, it could not ensure a high level of internal control. Outsourcing is regarded as an operational function and therefor it is very important to be performed throughout the life of the Investment Firm[121].

According to art.2 point 6 of Directive 2006/73, outsourcing means "*an arrangement of any form between an investment firm and a service provider by which that service provider performs a process, a service or an activity which would otherwise be undertaken by the investment firm itself."* Based on this definition, we could examine

[119] Richard Stones, 'Conduct of business: an update' Compliance Officer Bulletin (2006) 34-38.

[120] Richard Stones, 'Conduct of business: an update' Compliance Officer Bulletin (2006) 34-38.

[121] Tomasz Czech, Ewa Szlachetka, 'Outsourcing under MiFID' Journal of International Banking Law and Regulation' (2009) 146.

the general characteristics of outsourcing. First of all, outsourcing could be considered as a voluntary arrangement, which takes place between the investment firm and a service provider[122]. MIFID and regulations concerning outsourcing do not impose any obligation on Investment Firms to employ external providers and the regulations apply only to agreements between Investment Firms and their providers and not between a service provider and a customer of the Investment Firm. The Directive does not determine who could act as a service provider. As the Directive does not impose general limitations, it is considered that the service provider could be, for example, experts, national depositories of securities or custodian banks. They are considered to be external entities, separate from the Investment Firm in cooperation with which they provide their services. It should also be mentioned that if the service provider performs outsourced using third parties (so-called sub-outsourcing or chain outsourcing), it is also considers as outsourcing and this agreement also falls under MIFID Level 2 Directive[123].

According to MIFID Level 2, outsourcing is guided by some basic principles the most important of which are freedom of outsourcing, responsibility of Investment Firms for outsourcing and effective supervision. In addition, there are secondary principles more supplementary and technical, which act as guidelines for the operation of the key principles[124]. However, as mentioned above there are specific restrictions imposed by MIFID Level 2 concerning this freedom and set some limits to relevant outsourcing. For example, some restrictions are imposed by article 14 (2) and (3) according to which "*investment firms must verify if service providers have the ability, capacity, and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally"* and "*the respective rights and obligations of investment firms and of the service provider have to be clearly allocated and set out in a written agreement".* Moreover, according to Article 14(3) Member States will

[122] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 148.

[123] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 148.

[124] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 151.

require a written agreement including all the respective rights and obligations of the Investment Firms.

The freedom of outsourcing is closely associated with the responsibility of outsourcing. To put it differently, the Investment Firm is free to act, but it should also be responsible for its actions[125]. Any kind of investment risk associated with outsourcing should damage only the firm, which is the solely liable and not be unfairly transferred to others, such as the clients, who are in a disadvantageous position because of their limited bargaining power. The Member State should also maintain an efficient monitoring system in order to ensure competent authorities have the capacity to perform supervision by imposing specific obligation and restrictions. In that direction, Investment Firms are obliged to perform special functions such as "*ensuring that the investment firm's auditors and the relevant competent authorities have effective access to data related to the outsourced activities, as well as to the business premises of the service provider"* (art.14 s.2 point (i) of Directive 2006/73). Under the same article MiFID Level 2, the Directive obliges every investment firm to be in conformity with competent authorities for information necessary for the supervision of the compliance with the outsourced activities performed with the imposed requirements (art.14 s.5 of Directive 2006/73)[126].

The implementation of a set of detailed rules regulating outsourcing was imposed by the needs of Modern Market Structure and investment policies and had a great practical value. In fact, in recent years many Investment Firms, mainly because of economical reasons and cost reduction, made the decision to outsource functionality to third countries where they would be able to offer services at reduced costs compered to other businesses established in the European Union. For example, India is known in this field as an ideal supplier of call center services. Outsourcing to Third Countries might have an adverse effect on the functioning of Internal Market, especially, if there is no formalized protective environment imposed by the relevant

[125] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 152.

[126] Tomasz Czech,Ewa Szlachetka, 'Outsourcing under MiFID, Journal of International Banking Law and Regulation' (2009) 152.

legal instrument. In order to avoid that risk MIFID Level 2 Directive imposed certain requirements concerning outsourcing to Third Countries[127]. In particular, Article 15 includes specific provisions for the outsourcing in these cases. According to this, the Investment Firm should ensure that "*the service provider is authorized or registered in its home country to provide that service and must be subject to prudential supervision*". Furthermore, in order for outsourcing to a Third Country to be permitted, an appropriate co-operation agreement should have already taken place between the competent authority of the Investment Firm and the supervisory authority of the service provider located. In any case, the investment firm has the obligation to give a prior notification of the performance of any arrangement to its competent authority and the competent authority has the right to object within a reasonable time limit. If no objection is offered within this time period the arrangement can come into force[128].

V. The Markets in Financial Instruments Directive II ("MiFID II")

1. Introduction

The Markets in Financial Instruments Directive II (MiFID II)[129] is an updated version of MiFID, approved by the European Parliament in 16 April 2014 and had been put into force by 3 July 2016[130]. Member States were obliged to implement the Directive by then. However, its implementation was delayed until January 2018. MiFID II combines MiFID's provisions and is supplemented by the Markets in Financial Instruments

[127] Stuart Bazley, 'Outsourcing of critical business functions under the Markets in Financial Instruments Directive' Company Lawyer (2008) 247.

[128] Stuart Bazley, 'Outsourcing of critical business functions under the Markets in Financial Instruments Directive' Company Lawyer (2008) 247.

[129] *"Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, OJ. L. 173, 12.6.2014, pp. 349-496 (MiFID II)".*

[130] European Commission Website, <ec.europa.eu/info/law/markets-financial-instruments-mifid-ii-directive-2014-65-eu/law-details_en> accessed 15 February 2018

Regulation (MiFIR)[131]. The provisions of both legislative instruments are applicable in Member States from 3 January 2018.[132] The new Directive was the result of cooperation between the European Commission, European Securities and Markets Authority (ESMA), providing mainly technical advice, guidelines and recommendations and groups of experts and expertized committees[133].

In particular, MIFID II mainly brought about changes in the scope of the previous Directive as it limited the exceptions imposed by art 2 and 3 MiFID[134] and also regulated a modern field of investment activities concerning algorithmic trading and ensured an updated investors protection and adapted to the needs of Modern Markets. Despite the fact that it is a very recently implemented legal instrument and its effect has not become clear yet, it is considered that it will bring about a remarkable financial reform. MiFID, which covered the major part of this paper was the first efficient legal instrument imposed under the general effort of the EU to adapt Investment Services in the regime of the Internal Market. MIFID II constitutes an updated review, directed at the reforming of the previously applicable rules and the adaptation to technological and marketing developments[135]. As the most important terms and regimes have already been analyzed, at this point we will briefly try to mention some novelties under the new legal framework concerning the operation of Investment Firms.

2. Algorithmic Trading

[131] Simon Ramos, 'MiFID II Directive: Major change comes ahead' <www2.deloitte.com/lu/en/pages/mifid/articles/markets-financial-instruments-directive-mifidII.html> accessed 15 February 2018.

[132] Thomas M.J Moellers, 'European Legislative Practice 2.0: Dynamic Harmonisation of Capital Markets Law: MiFID II and PRIIP B.F.R.L. (2015) 145.

[133] European Commission Website, <ec.europa.eu/info/law/markets-financial-instruments-mifid-ii-directive-2014-65-eu/law-details_en> accessed 15 February 2018.

[134] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

[135] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

MIFID II recognized the evolution of high frequency trading (also referred as flash trading)[136], which was strongly contested among economists and financial analysts[137]. MIFID II succeeded in keeping a good balance between the need for regulating the new forms of automated trading and the risk entailed, caused by the overloading of the systems because of the unprecedented growth of the volume of orders and because of the complexity of the modern transactions. As a result, MiFID II permitted and recognized the need for high-frequency trading and algorithmic trading, but because of the high risk, the new legislation imposed a strict supervision system. As referred to in recital 59 of MIFID II '*The use of trading technology has evolved significantly in the past decade and is now extensively used by market participants. Many market participants now make use of algorithmic trading where a computer algorithm automatically determines aspects of an order with minimal or no human intervention. Risks arising from algorithmic trading should be regulated*.' In order to respond better to the Financial Market and to the changes imposed by the wider participation of clients in the Market[138], MIFID II also introduced the obligation of Investment Firms to ensure their clients direct electronic access (DEA) in order to carry out their transactions through electronic means with an imposed supervision system of high standard and by introducing a set of specific requirement and obligations for the Investment Firms[139], in order to decry the risks (Recital 66 MiFID II). The introduction of provisions regulating 'algorithmic trading (AT)', 'high-frequency algorithmic trading (HFT)' and 'direct electronic access (DEA)' was an innovation of MIFID II[140][141].

[136] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[137] Michael Lewis, 'Flash Boys: Cracking the Money Code' Penguin Books Ltd (2015).

[138] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[139] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[140] Art. 17 MiFID II.

[141] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 3.

In order to increase legal certainty, MiFID II contains definitions of the terms of 'algorithmic trading (AT) (Art. 4. (39)), 'high frequency algorithmic trading (HFT)' (art. 4 (40)) and 'direct electronic access (DEA) (art. 4(41))[142]. For the establishment of a risk protective regime, article 17 introduces specific requirements for Investment Firms providing AT and HFT imposing Internal Trading Systems properly monitored, (art 17 (1)), specific duties and obligations concerning the provisions of information about strategies, details of the trading parameters or limits to which the system is subject, the key compliance and risk controls (art 17.2) and imposes specific obligations to Investment Firms acting as market makers (Art 17(3).[143] In the same manner requirements concerning the operation of internal systems and monitoring are imposed on Investment Firms providing DEA according to article 17(5)[144].

Moreover, the new Directive focuses on the necessity of Investment Firms to provide Investment Services and products using modern technological instruments. MiFID II will facilitate to a great extent the firms' ability to act at a distance using electronic means and reducing the time required and the costs of the provided services. The modern needs gave rise to a regulatory desire, already expressed by MiFID I Level 2 Directive to expand trading beyond the limited capacity of the phone, which was an outdated means of communication and to be free to be performed by modern electronic venues, which provide better audit and surveillance trails[145].

The use of technological means will enable the operation of an immediate and effective information gathering system and the establishment of new monitoring methods, facilitating the direct and secure supervision by Member States. Moreover, this innovation could lead to a cost reduction, because of the simplifying of the applicable procedures. The new technological supporting systems, could be more

[142] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[143] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[144] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 12.

[145] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

easily adjusted to transparency and integrity obligations and could also facilitate the exercise of record keeping obligation too[146].

3. Conduct of Business Rules under MIFID II

The issue of investors protection also lies at the core of the new Directive. The obligations, which had been already introduced by previous legislation, are still imposed by MiFID II, forming an updated protective environment[147]. As analyzed above, MiFID I ensured a high-level investors protection system. The imposed rules of conduct were regarded as being strict. However, although MiFID II maintained overall the already known obligations, it increased the level of protection even further by introducing detailed provisions filing some gaps of the pre-existing MiFID I[148].

Before examining the revised provisions of MIFID II in the field of investors protection, it would be useful to underline the term of Investment Services under the new legislation. MiFID II separated the activities of the Investment Firm to the service of "dealing on own account" (Art. 4 lid 1 sub (4) MIFID II) and service of "dealing on behalf of the client" (Art. 4 lid 1 sub (5) MIFID II). This separation has a practical impact. As the rules of conduct aim to ensure investors protection after this segmentation, it is considered that these rules are applicable to Investment Services where Investment Firms "deal on behalf of the client"[149].

Concerning Investment Firms, investors protection obligations are imposed by art. 23-

[146] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

[147] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

[148] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 16.

[148] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 16.

[149] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 16.

30 MiFID II[150]. For the interpretation of these provisions, it should be mentioned that the clients classification system has not undergone considerable alterations under the new Directive (also see ANNEX II MiFID II). For example, the conflicts of interest rules, as they are imposed by article 23 MiFID II, have not been radically revised, compared to art. 18(1) MiFID[151]. Art. 25 also maintains the obligation of suitability test. Also the rules of best execution are not substantively revised. MiFID II addresses the obligation to take '*all sufficient steps'* to achieve the best result for the clients (art. 27 MIFID II) (there is a minor alteration compared to the phrase 'all reasonable steps' in 21 MIFID I, but it has no practical value). Neither do rules concerning client order handling present significant changes (Article 22 MiFID I; Article 28 MiFID II)[152].

After this brief presentation of the most important operating conditions in the field of investors protection, it is obvious that the conduct of business rules has not been imposed with fundamental changes, but they only include more details and are betted clarified[153]. However, taking into consideration the extensive content of the new provisions and art. 24 concerning the information obligations imposed on Investment Firms we could comment that the general information and reporting obligations are still predominant. However, MiFID II increases the volume of information that should be provided to the investor, and which should also include a great volume of details. In practice, this regime could be problematic. Despite the fact that the well-informed client is considered to be more capable of making well-considered decisions it is contested whether or not he could handle and evaluate such a great volume, or if this complexity would confuse him and result against him[154]. Moreover, the exhaustively detailed rules of conduct imposed on Investment Firms under MiFID II could be

[150] Martin Brenncke, 'Commentary on MiFID II conduct of business rules, Arts 21- 30 MiFID II' (2017) Forthcoming in Lehmann/Kumpan (eds.), Financial services law: a commentary, Beck/Hart/Nomos.

[151] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[152] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 4.

[153] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017).

[154] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017).

questioned. If their complexity results in the disability of the staff to implement them in the daily contact with the clients, these rules will be a dead letter and MiFID II will have ended up losing its practical effect[155].

4. Final thoughts

As the basic analysis of the most important requirements and procedures has already been provided above, at this point we overviewed only some basic points of MIFID II, which only recently was implemented and, as a result, we are currently waiting for its first practical impact on the Investment Market[156].

Because of the variety of new detailed provisions MiFID II is expected to bring about a significant impact on Financial Industry[157]. It goes without saying that the new rules deal with almost all aspects of trading in Internal Market. In particular, MiFID II provides rules concerning financial services, which could be provided by banks, institutional investors, exchanges, brokers, hedge funds and high-frequency traders[158]. The MiFID II introduces a set of measures, which seek to fill some gaps of MiFID I. This revision, if it is implemented in the right way, will have a huge impact on business strategy and the operation of Investment firms, which could take advantage of the efforts of modernalisation under MiFID II and start to plan for development[159].

[155] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017).

[156]Simon Ramos, 'MiFID II Directive: Major change comes ahead' <www2.deloitte.com/lu/en/pages/mifid/articles/markets-financial-instruments-directive-mifidII.html> accessed 15 February 2018.

[157] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

[158] Harry Boggis-Rolfe, 'What is Mifid II and how will it affect EU's financial industry?' (2017) <www.ft.com/content/ae935520-96ff-11e7-b83c-9588e51488a0 > accessed 15 February 2018.

[159] Simon Ramos, 'MiFID II Directive: Major change comes ahead' <www2.deloitte.com/lu/en/pages/mifid/articles/markets-financial-instruments-directive-mifidII.html> accessed 15 February 2018.

CONCLUSIONS

The presented legislation instruments brought about remarkable changes in the Investment Market. It goes without saying that this field could never operate efficiently without the establishment of a legal protective system. The field of Investment could barely be expanded to new players because of the high risks it entails. In order for the Investment Market to be expanded a legal framework focusing on investors protection was necessary. Investors have always had the need to feel protected and understand better the nature of financial products in order to make investment decisions. This necessity was firstly covered by ISD, which laid the foundation for this development[160].

Under this protective regime, imposed by a permanently updated legislation including ISD, MIFID (Level 1,2) and MIFID II, retail investors are encouraged to invest in European Financial Markets, reinforcing global economy by taking small steps according to their economic powers. Governments should encourage this situation by ensuring investors protection and increasing their confidence and their interest to invest leading to the right and efficient investment decisions[161]. However, it should also be underlined that the regulations will have practical value only if the operators of the Market, manufacturers and distributors act in goof faith and comply with all the provisions and this can be accomplished only with proper motivation and supervision by Member States[162].

The issue of investors protection is undeniably important, but the Market alterations in

[160] Gaetane Schaeken Willemaers, 'Client protection on European financial markets: from inform your client to know your product and beyond: an assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2' Revue Trimestrielle de Droit Financier (2014).

[161] Gaetane Schaeken Willemaers, 'Client protection on European financial markets: from inform your client to know your product and beyond: an assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2' Revue Trimestrielle de Droit Financier (2014).

[162] Gaetane Schaeken Willemaers, 'Client protection on European financial markets: from inform your client to know your product and beyond: an assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2' Revue Trimestrielle de Droit Financier (2014).

resent decades showed up and other significant issues. MiFID introduced certain duties and detailed supervision obligations of competent authorities by establishing robust, targeted and proportionate rules[163]. In order to be effective this legal instrument should, also, be adapted to the needs imposed by globalization and modernalization. Technological developments brought about major changes in the Financial Market operation and new trading venues have been established[164]. MIFID I was the first legal instrument, which tried to keep up with the new needs brought about by the complexity of transactions and investments by establishing a safer and more transparent financial system[165]. MiFID I imposed a detailed and efficient supervision system encouraging the participation of a wider variety of clients, even retail clients who were protected for the first time by a stable and unambiguous set of rules of conduct[166]. The liberalization of modern economies, the free movement of capital, the removed of frontiers, the digital interconnection of markets, the intermediation of professional managers with increased knowledge and the increase in new investors participation led to a great development of the Investment Market, which should be regulated by an updated legislation, adapted to the new conditions[167]. All these factors forced the Commission to propose a reform of the MiFID regime, firstly by MIFIL Level 2 and more effectively by MiFID II[168].

Beyond the already mentioned factors, the existing financial crisis also accentuates the

[163] European Commission, 'Proposal for aDIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in financial instruments [Recast]and theProposal for aREGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in financial instruments' Brussels, 20.10.2011.

[164] Nis Jul Clausen, Karsten Engsig Sorensen, 'Reforming the Regulation of Trading Venues in the EU Under the Proposed (MiFID II) – Leveling the Playing Field and Overcoming Market Fragmentation?' Nordic & European Company Law Working Paper (2012) 1.

[165] European Commission, 'Proposal for aDIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in financial instruments [Recast]and theProposal for aREGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in financial instruments' Brussels, 20.10.2011.

[166] European Commission, 'Proposal for aDIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in financial instruments [Recast]and theProposal for aREGULATION OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Markets in financial instruments' Brussels, 20.10.2011.

[167] Danny Busch, 'MiFID II: Regulating High Frequency Trading, Other Forms of Algorithmic Trading and Direct Electronic Market Access' SSRN (https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3068104) (2017) 1-4.

[168] Nis Jul Clausen, Karsten Engsig Sorensen, 'Reforming the Regulation of Trading Venues in the EU Under the Proposed (MiFID II) – Leveling the Playing Field and Overcoming Market Fragmentation?' Nordic & European Company Law Working Paper (2012) 1.

need for a constantly updated legal system. The crisis demonstrated the existence of the involved risks, and showed up the huge problem of inadequately capitalized Financial Instruments, which proved unable to deal with the new economical circumstances. If this situation is expanded it may demonstrate the need for new provisions imposing stricter rules ensuring Investment Firms insolvency[169].

It is obvious that the field of investments is a constantly changing one, which is influenced by numerous economical and social factors. A comprehensive review of the MiFID II, cannot be provided in a more appropriate way, yet, because it came into force last month. For the time being it can only be started that it has a wider scope, which will affect a broad range of stakeholders and will enable a wide use of modern technological means[170]. It remains to be seen if it will realize its objectives in practice[171].

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[171] Gaetane Schaeken Willemaers, 'Client protection on European financial markets: from inform your client to know your product and beyond: an assessment of the PRIIPs Regulation, MiFID II/MiFIR and IMD 2' Revue Trimestrielle de Droit Financier (2014).

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