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MiFID II – Analysis of Selected Issues Arising from the New Regulatory Package

Filip Oller

Abstract: *MiFID II and MiFIR were adopted in the light of the financial crisis in order to enhance the investor protection and to ensure transparent trading. Both referred to as MiFID II, they replace former MiFID I and cover securities, investment intermediaries, and trading venues. The aim of MiFID II is to put in place a single European rulebook regarding investment services and activities, including ancillary activities, and to strengthen the legal framework set up by MiFID I. In addition, MiFID II regulatory package is extended for the number of financial instruments. MiFID II requires that the trading is performed on regulated platforms. MiFID II rules reflect technical advances in the investment business as well. Therefore, regulatory framework regarding the high frequency trading was introduced. The date of entry into application of MIFID II is January 3rd, 2018. Such long period for entering into application is due to the complexity of the implementing process, mostly from technical point of view. MiFID II is very challenging for ESMA, national competent authorities, and for other stakeholders. The study is written from the perspective of investment firms as one of these stakeholders. The paper covers topics such as definition of investment activities, investment services and financial instruments, topic of passporting and the third country regime, incentives, suitability, and appropriateness of product design, information provided to client, execution only and best execution rules, records management, client assets, conflict of interests, complaints handling, client classification, corporate governance, commodity derivatives.*

Key Words: *MiFID II; MiFID I; MiFIR; Regulatory Package; Investment Services; Investment Activities; Ancillary Activities; Financial Instrument; Investment Firm; Client; the European Union.*

Introduction

Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on Markets in Financial Instruments amending the Council Directives 85/611/EEC and 93/6/EEC and the Directive 2000/12/EC of the European Parliament and of the Council and repealing the Council Di-

rective 93/22/EEC (hereinafter referred to as "MiFID I") had undergone several modifications leading to the adoption of a new regulatory package known as MiFID II. The very first idea behind adopting MiFID I was the fact that investors had become increasingly active on different financial markets and, therefore, their regulatory protection had become a priority for the European regulator. Progressive investment firms, including banks, were offering investors products that presented a higher degree of complexity. The range of offered products had been widened simultaneously with their increasing complexity. The European legislator was aware of the above-mentioned situation and its development, therefore, he decided upon a route to harmonization of the related regulation; hence, the legislator opted for a directive and a regulation as a European law-making instrument.[1] A consequence of more specific and complex

[1] From the most important European law related documents the following legal documents should be especially mentioned (in alphabetical order): *Consolidated Version of the Treaty on the Functioning of the European Union*. OJ EU C 326, 2012-10-26, pp. 47-390; *Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the Harmonisation of Transparency Requirements in Relation to Information about Issuers whose Securities are Admitted to Trading on a Regulated Market and amending Directive 2001/34/EC*. OJ EC L 390, 2004-12-31, p. 38; *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 EU L 145, 2004-04-30, pp. 1-44; *Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the Coordination of Laws, Regulations and Administrative Provisions Relating to Undertakings for Collective Investment in Transferable Securities (UCITS)*. OJ EU L 302, 2009-11-17, pp. 32-96; *Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the Annual Financial Statements, Consolidated Financial Statements and Related Reports of Certain Types of Undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC*. OJ EU L 182, 2013-06-29, pp. 19-76; *Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC*. OJ EU L 176, 2013-06-27, pp. 338-436; *Directive 2014/49/EU of the European Parliament and of the Council of 16 April 2014 on Deposit Guarantee Schemes*. OJ EU L 173, 2014-06-12, pp. 149-178; *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 EU L 173, 2014-06-12, pp. 349-496; *Proposal for a Directive of the European Parliament and of the Council amending Directive 2014/65/EU on Markets in Financial Instruments as Regards Certain Dates* [2016-02-10]. COM (2016) 56 final; *Proposal for a Regulation of the European Parliament and of the Council amending Regulation (EU) No. 600/2014 on Markets in Financial Instruments, Regulation (EU) No. 596/2014 on Market Abuse and Regulation (EU) No. 909/2014 on Improving Securities Settlement in the European Union and on Central Securities Depositories as Regards

financial service and activities offerings was the increasing dependence on investors' personal investment knowledge as well as the knowledge of their advisors.

The issuance and trading of financial instruments are essential to ensure the availability of capital in the economy and to ensure the capital is efficiently allocated. Financial instruments are used by economic agents such as companies to raise funds, e.g. for growth and innovation, or investors to invest their financial surplus and to seek financial returns. They are also used by entities to manage risks. Together with the services provided e.g. by banks, payment-service providers, and clearing and settlement infrastructures, the market in financial instruments is a backbone of a modern economy and essential to feed economic growth and innovation.[2]

From the law-making process point of view, the revision of MiFID I has led to the adoption of regulation and directive at the same time. The directive as a legislative instrument was chosen in order to grant legal approximation in the European Union Member States – Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and amending the Directive 2002/92/EC and the Directive 2011/61/EU (hereinafter referred to as "MiFID II"). The second part of the new regulatory package is Regulation (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and amending the Regulation (EU) No. 648/2012 (hereinafter referred to as "MiFIR"). Behind the choice of regulation as a legislative instrument may be observed

Certain Dates [2016-02-10]. COM (2016) 57 final; *Regulation (EU) No. 575/2013 of the European Parliament and of the Council of 26 June 2013 on Prudential Requirements for Credit Institutions and Investment Firms and amending Regulation (EU) No. 648/2012*. OJ EU L 176, 2013-06-27, pp. 1-337; *Regulation (EU) No. 600/2014 of the European Parliament and of the Council of 15 May 2014 on Markets in Financial Instruments and amending Regulation (EU) No. 648/2012*. OJ EU L 173, 2014-06-12, pp. 84-148; *Regulation (EU) No. 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC Derivatives, Central Counterparties and Trade Repositories*. OJ EU L 201, 2012-07-27, pp. 1-59; and *Regulation (EU) No. 909/2014 of the European Parliament and of the Council of 23 July 2014 on Improving Securities Settlement in the European Union and on Central Securities Depositories and amending Directives 98/26/EC and 2014/65/EU and Regulation (EU) No. 236/2012*. OJ EU L 257, 2014-08-28, pp. 1-72.

[2] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 3.

the will of the European legislator to harmonise the concerned questions at the European level. The Member States will have to implement the entire MiFIR regulation without any discretionary competence as they do have regarding MiFID II. Standard practice uses the abbreviation MiFID II to represent both the above-mentioned instruments – regulation (MiFIR) and directive (MiFID II). In this paper, this standard will be followed unless the abbreviation MiFIR is used explicitly. Despite the fact that the new regulatory package simultaneously contains a directive and a regulation, they both should be interpreted together and in reciprocal relation. The wording of MiFID II empowers in several provisions the European Commission to adopt delegated acts that along with the regulatory technical standards prepared by the European Securities and Markets Authority (hereinafter referred to as "ESMA")[3] both develop the content of MiFID II. However, the provisions of these delegated acts or regulatory technical standards will not be included in the content of this paper. They both present details with executive or technical characters denuded of any legal relevance.[4]

The main aim of this study is to provide insight into major changes that the new legislation of MiFID II brings to investment and banking in Europe from the legal point of view, including the resulting potential consequences. This paper sees MiFID II difficulties more from the investment firm point of view rather than from the side of the ESMA or the Member States in order to help investment firms to implement all relevant requirements. It should be mentioned that the question of implementation of MiFID II requirements into processes of an investment firm is highly specific and individual to each investment firm.[5]

Both MiFID II and MiFIR were scheduled to apply as of January 3rd, 2017. However, during the legislative process the very high level of complexity of the MiFID II package and the need for a significant number of implementation measures were recognised. Therefore, a period of 30 months was foreseen between entering into application and adoption in

[3] *ESMA: European Securities and Markets Authority* [online]. 2016 [cit. 2016-04-08]. Available at: https://www.esma.europa.eu/.

[4] MIFID (II) and MIFIR. In: *ESMA: European Securities and Markets Authority* [online]. 2016 [cit. 2016-04-08]. Available at: https://www.esma.europa.eu/policy-rules/mifid-ii-and-mifir.

[5] Updated Rules for Markets in Financial Instruments: MiFID 2. In: *European Commission* [online]. 2016 [cit. 2016-04-08]. Available at: http://ec.europa.eu/finance/securities/isd/mifid2/index_en.htm.

some cases. The usual period between the entry into application and adoption is estimated at 18 – 24 months. According to the opinion of the ESMA, the technical implementation challenges are of such magnitude that essential data infrastructures will not be in place in time for January 3rd, 2017, as expected initially. If the date of entry into application had remained unchanged, this would have meant, in practice, that neither competent authorities nor market participants would be in a position to apply the new rules by January 3rd, 2017. This could have led to legal uncertainty and potential market disruption.[6]

Origins of the new regulatory package

The overarching objective of MiFID II has been to further the integration, competitiveness, and efficiency of the European Union financial markets. MiFID I as well as MiFID II are predicated on a series of key principles: cross-border competition between investment firms and trading venues on a level playing field, market transparency, non-discriminatory and equal treatment of market participants, diligent corporate governance and avoidance of conflicts of interest by intermediaries, and suitable as well as effective protection of investors. In concrete terms, it abolished the possibility for the Member States to require all trading in financial instruments to take place on specific exchanges and enabled a Europe-wide competition between traditional exchanges and alternative venues. It also granted banks and investment firms a strengthened "passport" for providing investment services across the European Union subject to compliance with both organisational and reporting requirements as well as comprehensive rules designed to ensure investor protection.[7]

The financial crisis has woken the world to the issue of counterparty risk, notably with regards to over-the-counter (hereinafter referred to as "OTC") derivatives. The failure of a counterparty in a derivative transaction not only leave unhedged the counterparty but could also have systemic consequences for the whole financial system.[8]

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[6] *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 EU L 173, 2014-06-12, pp. 349-496.

[7] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 5.

[8] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for*

SOCIETAS ET IURISPRUDENTIA
2016, ročník IV., číslo 2, s. 111-141
http://sei.iuridica.truni.sk
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Actually, there are different financial instruments with different market features and different market participants. Financial instruments are usually split into three large categories: equities, debt instruments, and derivatives. These instruments can be traded on organised markets which is mostly the case for equities or OTC which is the case for most of the debt instruments and derivatives. In terms of respective size, total turnover on equities markets amounted in 2010 in Europe to nearly 19.9 trillion EUR. International and domestic debt securities markets in terms of outstanding issued debt amounted in March 2011 and December 2010 to respectively 29 trillion USD and 67 trillion USD for all countries out of which the Euro area countries and the United Kingdom accounted for 16 trillion USD and 15 trillion USD. The OTC derivatives markets in terms of notional amount outstanding amounted to 601 trillion USD as of end of December 2010.[9]

The MIFID I review is estimated to impose one-off compliance costs of between 512 and 732 million EUR and ongoing costs of between 312 and 586 million EUR. This represents one-off and ongoing costs impact of respectively 0.10 % to 0.15 % and 0.06 % to 0.12 % of total operating spending of the European Union banking sector.[10] Total MIFID II administrative burden is estimated to impose one-off compliance costs of between 254.8 and 402.3 million EUR and ongoing costs of between 90.5 and 190.4 million EUR.[11]

The problems that the revision of MiFID I is aiming to solve are multiple and can be grouped as follows:

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a Regulation of the European Parliament and of the Council on Markets in Financial Instruments [2011-10-20]. SEC (2011) 1226 final, p. 4.

[9] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 8.

[10] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 64.

[11] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 65.

- lack of a level playing field between markets and market participants has become exacerbated as new players and new trading techniques develop;
- difficulties for the small and medium-sized enterprises (hereinafter referred to as "SMEs") to access financial markets;
- lack of sufficient transparency of the financial markets for market participants;
- the lack of sufficient information and powers for national regulators regarding financial markets and intermediaries, and inconsistent supervisory practice (this covers commodities markets, transaction reporting, powers of competent authorities);
- existence of areas in which investor protection has revealed deficiencies. These areas are uneven coverage of service providers, uncertainty around execution only services, quality of investment advice, framework for inducements, provision of services to non-retail clients and classification of clients, execution quality, and best execution;
- weaknesses in some areas of the organisation, processes, risk control, and assessment of some market participants. This concerns the question of insufficient role of directors and insufficient organizational arrangements for the launch of new products, operations, and services and weaknesses in internal control functions;
- lack of specific organisational requirements for portfolio management, underwriting and placing of securities, and uneven regime for telephone and electronic recording.[12]

The impact assessment for MiFID II defines the general objectives of the revision of MiFID I. The revision aims to strengthen investor confidence, to reduce the risks of market disorder, to reduce systemic risks, to increase efficiency of financial markets, and to reduce unnecessary costs for participants.[13]

[12] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 9.

[13] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, pp. 20-21.

Specific policy objectives are to ensure a level playing field between market participants, to increase market transparency for market participants, to reinforce transparency towards and powers of regulators in key areas and to increase coordination at European level, to raise investor protection, and, finally, to address organisational deficiencies and excessive risk taking or lack of control by investment firms and other market participants.[14]

The operational objectives are appropriate regulation of all market and trading structures, taking into account the needs of smaller participants, especially SMEs, set-up of relevant framework around new trading practices, improvement of trade transparency for market participants on equities and its increase for non-equities market, strengthening of transparency towards and powers of regulators, improvement of consistency in the implementation of rules and coordination in supervision by national regulators, enhancement of transparency and oversight of commodities derivatives markets, regulation reinforcement on products, services, and services providers when needed, strengthening of the rules of business conducts of investment firms, stricter organizational requirements for investment firms.[15]

Differences in definition of investment activities, services, and financial instruments

At the very beginning of the paper it is for practical reasons worth to define the differences between the former definitions of terms such as "Investment Activities", "Investment Services", and "Financial Instruments" under MiFID I and the definition according to the new MiFID II legislation.

In comparison with MiFID I, the understanding of the term investment services and activities found in Section A, Annex I of the MiFID II has been extended to include operations of an organised trading facility (hereinafter referred to as "OTF"). Ancillary services in Section B of An-

[14] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, pp. 20-21.

[15] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, pp. 20-21.

nex I have not undergone any significant changes that may have an important impact on the functioning of the majority of investment firms. The wording of the first point regarding safekeeping and administration of financial instruments in client accounts was specified and excludes maintaining security accounts at the top tier level. The understanding of the term financial instruments which can be found in Section C, Annex I of MiFID II has been specified regarding emission allowances, commodities, and OTF.

Passporting and the third country regime

The first idea to be mentioned regarding the provision of services is the fulfilment of the Member State national level requirements when the services are offered in another Member State. These requirements were defined by the Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on Access to the Activity of Credit Institutions and the Prudential Supervision of Credit Institutions and Investment Firms, amending the Directive 2002/87/EC and repealing the Directives 2006/48/EC and 2006/49/EC. Investment services and activities, including ancillary services, can be provided in the Member State when a branch of the investment firm is established or through the use of a tied agent established in a Member State. In the case of the use of the tied agents the activities performed by this agent have to be covered by the authorisation granted to the investment firm or the credit institution in the home Member State.[16]

According to the provision of the Article 35 of MiFID II, an investment firm may only provide ancillary services together with an investment service and/or activity in a Member State where the investment firm wishes to offer its investment services or to perform its investment activities on behalf of the client. The notification duty may be required when the investment firm decides to operate on the market of another Member State through a branch or a tied agent. This obligation is towards the competent authority of the home Member State.[17] This requirement was present under MiFID I as well.

[16] Article 35 and Article 39 of the *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 EU L 173, 2014-06-12, pp. 349-496.

[17] Article 35 and Article 39 of the *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 EU L 173, 2014-06-12, pp. 349-496.

SOCIETAS ET IURISPRUDENTIA
2016, ročník IV., číslo 2, s. 111-141
http://sei.iuridica.truni.sk
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From the regulatory point of view, MiFID II differentiates the regulatory requirements when the investment service is offered to professional clients or retail clients. When an investment firm from a third country wants to offer investment services and activities, including ancillary services, to retail clients, as defined in the Annex I of MiFID II, it may be required to establish a branch of its firm in one of the Member States. When the branch is established in one Member State, it does not subsequently mean that it can have access to regulated markets in other Member States. Other Member States can require the establishment of a branch in their territory as well. Furthermore, Article 39 of the MiFID II lays down requirements for the establishment of a branch in a Member State. In addition, the Article widens the scope of the Article 39 describing the authorization process for establishing a branch in a Member State. In comparison with the provisions of MiFID I, the legal framework for the authorisation of establishment of a branch in a Member State for the purpose of offering services to retail clients (as defined in Annex I of MiFID II) has become stricter.[18]

The main question arising from these new regulatory issues brought by MiFID II is the revision of the business approach of investment firms regarding the distribution of their investment services and/or activities, including ancillary services, when offering investment services and activities in other Member States. Attention will have to be paid by individual investment firms regarding the target market and the way of offering their services. This means that investment firms may have to decide either to offer their services in other Member State through a branch, a tied agent, or not at all.

Inducements

Another major topic which is worth covering in this study and which is the subject of new MiFID II elements is the issue of inducements. Some Member States such as the Netherlands have prohibited inducements from being provided to investment firms as the Member States are allowed to adopt rules that are stricter in comparison with rules covered in the MiFID II. The question of inducements or incentives belongs to the wider context of the conflict of interests defined in the Article 23 of MiFID II. The reason for this regulatory point is the loss of confidence in in-

[18] Article 39 of the *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 EU L 173, 2014-06-12, pp. 349-496.

vestment firms. Some firms were previously exposing their clients to excessive risks. The aim of restricting provision of inducements under the MiFID II is to grant the independence of investment firms from being influenced by third parties. The question of independence is closely linked with the problem of the remuneration of investment firms and related employees. Incentives may have monetary or non-monetary character. The key idea of the new legislation is to prohibit providing inducements when investment firms offer products in the form of providing independent investment advice and in the form of portfolio management for clients. However, incentives can be provided in a limited number of cases such as execution only client services and when investment advice does not have an independent character. It may seem logical that in these two cases inducements are allowed as the independence of the investment firm will not be affected. When providing independent investment advice, it is necessary to periodically assess the suitability of financial instruments offered to specific clients or the range of financial instruments. In this respect, it is advised to perform an annual review. It is essential to disclose the costs for such a recommendation or piece of advice and the basis on which it is founded.[19]

MiFID II contains specific provisions regarding remuneration which were not a subject of MiFID I.[20] However, in 2013 the ESMA published a remuneration guidance paper.[21] The consequence of this new provision related to incentives may be the review of the remuneration policies including regular policy review, review of product structure, and adjusting the product suitability for specific clients. It should be mentioned that this topic is relevant exclusively for those investment firms that provide independent investment advice or/and client portfolio management.

In the context of the financial crisis and recent debates on the quality of investment advice several possible areas for improvement have

[19] Article 23 of the *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 EU L 173, 2014-06-12, pp. 349-496.

[20] *Guidelines on Remuneration Policies and Practices (MiFID)* [online]. 1st ed. Paris: European Securities and Markets Authority, 2012-09-17. 39 p. [cit. 2016-04-08]. Consultation Paper, no. ESMA/2012/570. Available at: https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-570_0.pdf.

[21] See more in the Consultation on Guidelines on Remuneration Policies and Practices (MIFID). In: *ESMA: European Securities and Markets Authority* [online]. 2016 [cit. 2016-04-08]. Available at: https://www.esma.europa.eu/press-news/consultations/consultation-guidelines-remuneration-policies-and-practices-mifid.

SOCIETAS ET IURISPRUDENTIA
2016, ročník IV., číslo 2, s. 111-141
http://sei.iuridica.truni.sk
ISSN 1339-5467

emerged. Under the MiFID I, intermediaries providing investment advice are not expressly required to explain the basis on which they provide advice (e.g. the range of products they consider and assess); more clarity is thus needed as to the kind of service provided by the intermediary. According to the assessment impact for MiFID II regulatory package at present, investment advice is unsuitable roughly half of the time.[22]

Suitability and appropriateness

Under suitability and appropriateness, MiFID II means that investment firms which manufacture investment products must ensure that the architecture of these products meets client needs and that the target market is identified as well as the client category. Moreover, investment firms are supposed to ensure that only products designed for a specific class of clients are offered to clients those belong to the identified target market and in this regard the investment firm is supposed to carry out the periodical review of the identified target market. On the other hand, if the investment product is not manufactured by the investment firm itself and it is only recommended or offered by the firm, the investment firm has to obtain all relevant information from the product manufacturer in order to be able to understand the approval process set up during the product development regarding its characteristics and the above-mentioned identified target market. In this case, the investment firm has to take into consideration the product characteristics as well as the objectives and needs of the concerned client.[23]

In order to grant the MiFID II requirements regarding suitability and appropriateness of a certain product that is offered to the client, investment firms have to perform periodical assessment of their investment services and activities provided to clients, including ancillary services. This requirement is satisfied in practice via account statements that are sent to the client on an annual basis. Hence, the structure of the account statement sent to the client will have to be modified. In this respect, the nature of services and/or activities that the investment firm provides to

[22] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 16.

[23] Article 25 of the *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 EU L 173, 2014-06-12, pp. 349-496.

the client as well as costs and fees which are related to the offered or recommended product have to be taken into account. Complexity and type of product have to be determined too for the preparation and layout of the client account statement.[24]

Products

The relevance and importance of product design is dependent on the complexity of investment products which undergo continuous metamorphosis regarding their design. Therefore, the up-to-date knowledge of the investment firm's employees is a challenge for the investment firm itself, as it is crucial that the right target market is correctly chosen by the investment firm. Simply speaking, the right product has to be offered or recommended to the right client in order to avoid the exposure of the client to improper risk. The sound knowledge of the range of advised or offered investment products or activities of the investment firm has to be gained. For this purpose, sufficient resources and time have to be allocated regarding the employees of the investment firm.

In order to ensure the protection of investors regarding the product design it is necessary that the investment firm develops and puts in place relevant process for product approval as well as the review of this process. In line with the provision of the Article 16, Section 3 of MiFID II investment firms have to specify the approval process for all products that they offer to their clients. This process shall include the identification of the target market and the end client within a certain category of clients. This has to be carried out for each financial instrument. In addition, the risk rate regarding each financial instrument and client has to be assessed. The distribution strategy for the product has to be in line with the defined and chosen target market.[25]

While the periodical product review is carried out, it is advised that this is done on an annual basis. It is also recommended that investment firms focus on the product performance as well as on the development of different risk scenarios resulting in prevention of client losses. Furthermore, the consistency of the relation between the needs of clients and the

[24] Article 25 of the *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 EU L 173, 2014-06-12, pp. 349-496.

[25] Article 16 of the *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 EU L 173, 2014-06-12, pp. 349-496.

identified target market has to be assessed and periodically checked. According to the distribution strategy, it may occur that this will have to be adjusted and will have to be made public in order to grant a higher level of transparency.

From the practical point of view, it is advised that the above-mentioned process shall be implemented in an internal policy paper that will be binding for the investment firm. The details of this process will undoubtedly depend on the needs of individual investment firms. The practice in the banking sector has proven that the approval process and its review should be implemented in a separate policy with general charter. Due to the frequent innovations and up-dates of specific products it is worth considering to prepare individual policies for individual products, as it is necessary to identify the target market, the end client, the risk that may occur for the client as well as the distribution of the product. Therefore, all these questions may be covered in one policy for one product.

In comparison with MiFID I, it can be said that the new MiFID II regulatory package seems to be more specific and develops more of the above-mentioned questions related to investment products and their design in order to grant a higher level of transparency. At the same time, these requirements may be used as general guidelines for the design of every product.

Information for clients

Another important topic in the MiFID II package is the information given or provided to the client by the investment firm. It belongs to the transparency requirements which are supposed to enhance the investors' confidence and to avoid their imprudent exposure to risk. Information provided to clients and potential clients shall be fair, clear, and not misleading. This applies also to marketing documents addressed to clients by investment firms.[26]

When investment firms provide investment advice, it is necessary to inform clients whether this advisory activity has independent character or not. Another requirement for the information provided to clients regarding the investment advice is whether the advice is based on a broad or more restricted analysis of different types of financial instruments.

[26] Article 24 of the *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 EU L 173, 2014-06-12, pp. 349-496.

Notably, it has to be defined whether the range which is offered or recommended is limited to financial instruments issued or provided by entities having close links with the investment firm or any other legal or economic relationships, such as contractual relationships. The need to provide this sort of information aims to avoid impairing the independent basis of the advice provided by investment firms. Investment firms have to inform clients on the periodic assessment of the suitability of the financial instruments which are offered to them.[27]

Furthermore, the information provided to clients has to include a risk warning mentioning whether the financial instrument has been designed for professional or retail clients, taking into consideration the identified target market. As part of the above-mentioned information it is mandatory to include details related to all fees and costs that are charged to clients for transactions. This is required both for investment services and activities, including ancillary services. The third party costs and fees have to be encompassed as well. Besides the costs and fees for providing certain investment services it has to be mentioned what is the expected return from the investment transaction. In practice, investment firms use information leaflets to provide all this information to their clients before concluding a transaction and annually during the existence of transition. In cases where the transaction life does not exceed one year, it is advised to provide the information at least once.

In comparison with MiFID I, the main difference which is worth mentioning consists of the fact that MiFID I requires disclosure of the total price for the investment service that was provided. However, MiFID II requires that this disclosure is more detailed. Every item that constitutes the final price has to be listed and presented to the client. Furthermore, MiFID I requirements regarding the investment advice were less detailed; it was namely the case of the scope and character of the provided investment recommendation.

The question arising from these new regulatory matters which seems to be the most relevant is that of potential impacts within a certain investment firm. It does not mean that these impacts will apply to all investment firms. However, it may be estimated that following aspects are of a general character regarding MiFID II and information for clients. Mi-

[27] Article 24 of the *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 EU L 173, 2014-06-12, pp. 349-496.

FID II might therefore lead to the revision of the documents providing information to clients before concluding a transaction. Likewise, the information technologies (hereinafter referred to as "IT") infrastructure of investment firms may need to be updated regarding the new requirements. Finally, from the strategic point of view, investment firms have to consider offering investment advice on non-independent or independent basis.

Execution only

The question of execution has been broadened under the MiFID II. MiFID I was less demanding regarding the execution requirements. Advances in the financial sector in connection with the IT have led to innovations such as high frequency trading. High frequency trading has brought the investment business to a new level. Hence, the European legislator has been estimating when performing the review of MiFID I that high frequency trading has to be regulated as well. The question of the high frequency trading may seem very specific and not very common. High frequency trading is a form of trading which has found its place in investments thanks to technological advances. It uses different mathematical models for making transaction decisions, such as algorithms. The principle of this trading means analysing data or signals from the market at high speed and then sending or updating large numbers of orders within a very short time period in response to the analysis. It may contain elements such as order initiation, generating, routing, and execution which are determined by the system without human intervention for each individual trade or order, short time frame for establishing and liquidating positions, high daily portfolio turnover, high order-to-trade ratio intraday and ending the trading day at or close to a flat position.[28]

It is necessary to establish a comprehensive regulatory regime governing the execution of transactions in financial instruments irrespective of the trading methods used to conclude those transactions so as to ensure a high quality of execution of investor transactions and to uphold the integrity and overall efficiency of the financial system. A coherent and risk-sensitive framework for regulating the main types of order-execution arrangement currently active in the European financial marketplace should be provided for. It is necessary to recognise the emer-

[28] Points 61 and 62 of the *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 EU L 173, 2014-06-12, pp. 349-496.

gence of a new generation of organised trading systems alongside regulated markets which should be subjected to obligations designed to preserve the efficient and orderly functioning of financial markets and to ensure that such organised trading systems do not benefit from regulatory loopholes.

High frequency trading is facilitated by the co-location of market participants in close physical proximity to a trading venue by a matching engine. In order to ensure orderly and fair trading conditions, it is essential to require trading venues to provide such co-location services on a non-discriminatory, fair, and transparent basis. The use of trading technology has increased the speed, capacity, and complexity of investor trading. It has also enabled market participants to facilitate the direct electronic access to markets through the use of trading facilities, through direct market access, or sponsored access. Trading technologies have provided benefits to the market and market participants, such as wider participation in markets, increased liquidity, narrower spreads, reduced short term volatility, and the means to obtain better execution of orders for clients. Yet that same trading technology also gives rise to a number of potential risks such as an increased risk of the overloading of trading venue systems due to large volumes of orders, risks of algorithmic trading generating duplicative or erroneous orders, or otherwise malfunctioning in a way that may create a disorderly market.

When establishing the business relationship with the client, the investment firm might ask the client or potential client to consent at the same time to the execution policy as well as to the possibility that that person's orders may be executed outside a trading venue. With respect to transactions executed between eligible counterparties, the obligation to disclose client limit orders should only apply where the counterparty is explicitly sending a limit order to an investment firm for execution.

The existing recordings of telephone conversations and data traffic records from investment firms executing and documenting the executions of transactions as well as existing telephone and data traffic records from telecommunications operators constitute crucial and, sometimes, the only evidence to detect and to prove the existence of market abuse as well as to verify compliance by firms with investor protection and other requirements set out in MIFID II or in MiFIR. Therefore, competent authorities should be able to require existing recordings of telephone conversations, electronic communications and data traffic records held by an

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investment or credit firm. Access to data and telephone records is necessary for the detection and penalising of market abuse or of infringements of requirements set out in MIFID II or in MiFIR.

Best execution

MiFID II stresses the importance of the best execution of clients' orders. Execution has to be carried out on terms that are most favourable to the client. This applies where a firm owes contractual or agency obligations to the client.[29] The requirements for the best execution are defined in the Article 27 of MiFID II.

When an investment firm is executing orders, it has to take all sufficient steps to obtain the best possible result, taking into account price, costs, speed, likelihood of execution and settlement, size, nature, or any other consideration relevant to the execution of the order. MiFID II specifies further requirements on the execution of orders regarding retail clients. If an investment firm executes an order on behalf of a retail client, the best possible result shall be determined in terms of the total consideration, representing the price of the financial instrument and the costs relating to execution. It shall include all expenses incurred by the client which are directly relating to the execution of the order, including execution venue fees, clearing and settlement fees, and any other fees paid to third parties involved in the execution of the order.[30]

In addition, it is prohibited that the investment firms receive any remuneration, discount or non-monetary benefit for routing client orders to a particular trading venue or execution venue in the case that this routing would breach the principle of prohibition of the conflict of interests or principles regarding incentives. The investment firms have to develop an order execution policy aiming at the best possible result for their clients' orders. The content of the order execution policy has to be structured in respect of each class of financial instrument. It has to include information on the different venues where the investment firm executes client orders and on the factors affecting the choice of execution venue. It should be mentioned in order execution policy which trading

[29] Point 91of the Introduction of the *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 EU L 173, 2014-06-12, pp. 349-496.

[30] Article 27 of the *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 EU L 173, 2014-06-12, pp. 349-496.

venues enable the investment firm to obtain, on a consistent basis, the best possible result for the execution of client orders. The order execution policy is supposed to explain clearly, in sufficient detail, and in a way that can be easily understood by clients how orders will be executed by the investment firm for the client. It is also required that the client has to expressly agree with this policy. When an investment firm executes client order, another requirement is to prepare a summary of all orders which were executed over the year. This has to be done for each class of financial instruments. The summary has to include the top five execution venues in terms of trading volumes where the client orders were executed in the preceding year and information on the quality of execution obtained. The update of this summary is supposed to be done on the annual basis.[31]

A consequence of the new requirements is a possible change in the best execution policy being needed. Thus, it is advised that the best execution policy is completely reviewed in order to fully comply with MiFID II requirements. The best execution policy has to cover all categories of financial instruments that the investment firm offers as products.

Furthermore, the way of treating and keeping trading data should be taken into account, as there is a requirement to publish the above-mentioned summary. The IT infrastructure may have to be redesigned in order to process the client orders in compliance with the demands of MiFID II. Moreover, the specific characteristics of a financial instrument shall be considered regarding the type of the client to whom it is offered or recommended, the nature of the order, and the trading venue where the client's order appears at the very last stage.

Records management

The topic of the records management has been broadened under the MiFID II. It seems to be very challenging for investment firms to implement and to process these regulatory requirements from the technical point of view. MiFID I required the retention of information and the Member States had the discretionary right to oblige investment firms to record information on orders. They could also choose whether they would oblige investment firms to record telephone and electronic communications. However, under the MiFID II, the recording of phone calls and elec-

[31] Article 27 of the *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 EU L 173, 2014-06-12, pp. 349-496.

tronic communication has become obligatory for investment firms. This has to be performed regarding all financial instruments and executions of orders. Moreover, all communication which aims to conclude transactions has to be stored as well. Clients must be aware of the fact that the conversation is recorded. The purpose of this new requirement is to enhance investor protection. The communication carried out through mails, e-mails, and faxes and orders made during personal meetings have to be saved on a durable medium. All communication has to be stored for five years. In some Member States, it may be required that this data is kept for up to seven years.[32]

Where orders are communicated to clients through other channels than by telephone, such communications should be stored in form of a durable medium as well (in form of mails, faxes, e-mails, documentation of client orders made at meetings). For example, the contents of relevant face-to-face conversations with a client could be recorded by using written minutes or notes. Such orders should be considered to be equivalent to orders received by telephone. Where minutes are taken during a face-to-face conversation with clients, the Member States should ensure that appropriate safeguards are in place to ensure that the client does not lose out as a result of the minutes inaccurately recording the communication between the parties. Such safeguards should not imply any assumption of liability by the client.

The investment firm has to record all communication with the client which may result in the conclusion of the contract when the clients are dealing on their account or when it concerns client order services (reception, transmission, and execution of orders), even though the communication may not result in such a conclusion. The investment firm has to provide the client with a copy of the communication if it is requested. The employee of the investment firm or the contractor has to avoid the use of private devices for recording the communication with the client if the investment firm is not able to record the communication on such device.

The issue of data keeping or recording seems to be very challenging for investment firms, as it requires the development of new processes and related infrastructure within the investment firm. The investment firms will be required to develop or to update their record keeping poli-

[32] Article 16 of the *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 EU L 173, 2014-06-12, pp. 349-496.

cy, including the processing of recorded data. In this respect, it is important to consider personal data protection and to make sure that the record keeping policy complies with the relevant legal acts on the personal data protection. Finally, the channels used for communication with the clients for the purpose of concluding transactions have to be taken into account and the choice of these channels may be reconsidered from the strategic point of view in order to fully comply with MiFID II requirements regarding records management.[33]

Client assets

MiFID II brings new regulatory standards which are in respect with assets belonging to clients and which are used to secure the transaction. The aim of the European regulator was to protect the client assets which are supposed to cover any eventual loss resulting from the transaction. The practice was using the title transfer collateral agreements which have become very restricted under the MiFID II. Regarding the retail clients, such transfer is prohibited and the client must remain the owner of the collateral during the transaction. This applies also to present, future, contingent, or prospective obligations. However, in the case that the transfer of the title of the financial collateral was used by the investment firm prior the MiFID II adoption, it is advised to refer to the Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on Financial Collateral Arrangements which may be help to set up the process for transaction using the title transfer collateral arrangement.

If the financial collateral agreement is concluded between the client and the investment firm, it is required that the client stays the owner of the financial collateral or, in the event that the collateral is provided by a third person, this person has to remain the owner of the collateral. Although, if the title is transferred and the investment firm becomes the new owner of the collateral provided by the client, the agreement concluded between the firm and the client has to stipulate the obligation to return the equivalent collateral to the client.

In respect of professional clients and eligible counterparties, the EMSA shall issue guidelines regarding the conclusion of title transfer collat-

[33] Article 16 of the *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 EU L 173, 2014-06-12, pp. 349-496.

eral agreements. In addition, the Member States can require the fulfilment of further conditions when the title transfer collateral arrangement is concluded. On the other hand, when investment firms use tied agents for performing their business, the legislation of a Member State may allow the tied agent to hold the collateral on behalf of the investment firm and under its full responsibility.

MiFID I seems to be less specific regarding the title transfer collateral agreements between clients and investment firms. MiFID I does not provide any details prohibiting the use of this contractual instrument regarding types of clients (retail clients, professional clients, and eligible counterparties). In addition, it was prohibited to retain as collateral the securities which were financing the transaction itself. MiFID II applies for this case as well and prohibits the use of the client securities financing the transaction as collateral.

According to the previous paragraphs, it may seem that the use of the transfer of the title is less convenient for investment firms under the MiFID II. Therefore, in the case that this legal instrument was used by certain investment firms, the firms will have to review all collateral contracts related to the investment business, including those used with tied agents, in order to be compliant with this MiFID II requirement. In order to grant the secure position of the investment firm and in order to grant compliance with MiFID II it is recommended to use the pledge contract instead of the transfer of the ownership. The prohibition of the use of title transfer may affect revenue and, secondly, the pricing strategy may have to be reviewed as well.

Conflict of interests

As it was already mentioned, the loss of confidence of clients in the investment business had led to the new MiFID II regulatory package. Hence, the conflict of interests between investment firms and their clients had to be avoided. Investment firms have to introduce their own policy to prevent conflict of interests which may occur. This policy has to cover cases when the investment firm offers investment advice or accepts incentives from third parties.

In comparison with MiFID I regulatory package, investment firms' policy on conflict of interests has to identify points of conflict that are likely to arise in respect to offered investment services and activities, including ancillary services, by investment firms. In reality, this means that

every firm will have a unique policy in respect to the portfolio of the offered services and/or performed activities. Both under the MiFID I and MiFID II, the origin of the conflict has to be disclosed to the client after being identified in relation to the relevant provisions.

Complaints handling

Regarding the issue of complaints handling or the extrajudicial mechanism for consumer complaints, MiFID II requires that investment firms have a written Complaint Policy which has to describe the process as to how the complaints are processed and handled. MiFID I required investment firms to establish processes for this purpose. Although MiFID II is more specific in this regard and requires that the policy is in a written form, it has to be published as well. Therefore, it is advised that such policy is published on the webpage of the investment firm. The processing of submitted complaints has to be free of charge and the result of the complaint procedure has to be announced to the client without unjustified delay. The scope of such policy shall apply to professional clients as well as non-professionals. Investment firms have to be able to provide the competent Member State authority with all relevant details concerning a specific complaint if such information is requested by the authority. MiFID II and MiFIR refer in several provisions to the term "Competent Authority"; every Member State will define by itself which body will fulfil the role of competent authority in each Member State.

Another requirement regarding the resolution of disputes which may occur between investment firms and their clients is membership of investment firms to an extrajudicial body which is enabled to resolve such disputes. For instance, in certain cases, an extrajudicial body can act as a court of arbitration where the investment firm holds membership. This extrajudicial body is supposed to cooperate with the same bodies in other Member States in cases of cross-border disputes.

As a result of these regulatory modifications regarding the complaints policy the review of its content should be considered, including the related work flow, in order to be compliant with MiFID II. Investment firms have to become members of extrajudicial bodies as well.

Client classification

MiFID I suffers from the misplaced assumption that professional investors know what is the best for themselves and the market as a whole, so

that there could be minimal oversight of complex wholesale markets.[34] Different investors need different degrees of protection. Investors should be able to be served by trustworthy market participants from across the European Union. Investment firms and trading venues need to abide by strong organisational rules in order to avoid market disorder or excessive volatility in some asset classes from undermining trust in all financial instruments and in the ability of the economy to finance itself.[35]

In the current MiFID I framework, clients are classified in three categories: retail clients, professional clients, and eligible counterparties. The level of protection and the level of requirements for investment firms in serving these clients decrease from retail clients to professional and eligible counterparties; the underlying principle being that larger entities have access to more information, benefit from higher expertise and are more able to protect themselves.[36]

The structure of the client classification remains unchanged under the MiFID II, but the topic of client classification has undergone few modifications under the MiFID II as well. It can be found in the Article 30 of MiFID II. In addition, MiFID II stipulates that municipalities and local public authorities are classified as retail clients unless they expressly wish to opt for professional client status, although it is not possible for municipalities and local public authorities to become an eligible counterparty.[37]

This is a step forward for enhancing the protection of municipalities and local public authorities when they act as investors. This measure enhances subsequent protection of public finances when they carry out

[34] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 5.

[35] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 6.

[36] *Impact Assessment: Accompanying the Document Proposal for a Directive of the European Parliament and of the Council on Markets in Financial Instruments and the Proposal for a Regulation of the European Parliament and of the Council on Markets in Financial Instruments* [2011-10-20]. SEC (2011) 1226 final, p. 17.

[37] Point 104 of the Introduction of the *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 EU L 173, 2014-06-12, pp. 349-496.

transactions on relevant trading venues. From the perspective of investment firms, this will require a change of classification of clients and wholesale review of their client portfolio. As for every client a "Know-Your-Customer" check has to be performed, this procedure may be reviewed and adapted as well. Thanks to the special character of municipalities and local public authorities and this new legal requirement, the conduct of the business of investment firms towards municipalities and local public authorities should be reconsidered.

Corporate governance

MiFID II stresses the importance of the question of corporate governance as previously some weaknesses at the international level have been observed in a number of financial institutions. The lack of effective checks and balances had become a factor that was contributing to the financial crisis. MiFID II aims to remedy this situation and to mitigate this risk in the future.[38]

The scope of the term "Management Body" covers investment firms, market operators, or data reporting services providers. The role of the management body of the investment firm is supposed to be strengthened. Thus, the management body has to be accountable for ensuring sound and prudent management of the firm and promotion of market integrity and interests of investors. The management body should at all times commit sufficient time and possess adequate collective knowledge, skills, and experience to be able to understand the firm's activities, including the main risks.[39]

The management body has to be able to control and to oversee, in an effective way, the activities of the entity. Another responsibility which is borne by the management body is the overall strategy of the firm, including its investment business, being in relationship with the risk profile of the company. Hence, the management body of the firm has to assume clear responsibilities across the business cycle of the firm. This extensive requirement covers identification and definition of the strategic objectives, risk strategy and internal governance of the firm, approval of the

[38] Point 5 of the Introduction of the *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 EU L 173, 2014-06-12, pp. 349-496.
[39] Point 53 of the Introduction of the *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 EU L 173, 2014-06-12, pp. 349-496.

internal organisation of the investment firm, including criteria for selection and training of employees, effective oversight of senior management, definition of overall policy governing the provision of services and activities, including the remuneration of sales staff and the approval of new products for distribution to clients. In order to grant the soundness and prudence of the investment firm's management, the periodic monitoring and assessment of the strategic objectives of the firm, its internal organisation and policies for the provision of services and activities have to be carried out. It is necessary to limit the number of directorships of a member of the management body that may be held at the same time in different entities. Combining too high a number of directorships would preclude a member of the management body from spending adequate time on the performance of that oversight role. All these requirements for the architecture of the management body may result in the review of the structure and functioning of the management body of the investment firm.[40]

According to the provisions of the Article 9 of MiFID II, the management body has to define, to approve, and to oversee the organisation of the firm for the provision of investment services and activities, including ancillary services, skills, knowledge and expertise required by personnel, the resources, the procedures, and the arrangements for the provision of services and activities, taking into account the nature, scale, and complexity of its business. All these requirements have to be in compliance with the policy concerning offered or provided services, activities, products, and operations. The risk rating of the firm has to be taken into consideration and it has to be deemed in connection with characteristic needs of clients. An appropriate stress testing has to be carried out too. The firm has to develop a remuneration policy for persons who are involved in the provision of investment services and activities, including ancillary services, to clients. The aim of this policy is to encourage responsible business conduct, fair treatment of clients, and avoiding conflict of interests between clients and investment firm.[41]

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[40] Point 54 of the Introduction of the *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 EU L 173, 2014-06-12, pp. 349-496.

[41] Article 9 of the *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 EU L 173, 2014-06-12, pp. 349-496.

Commodity derivatives

The European legislator had expressed opinion that it is appropriate to include in the list of financial instruments commodity derivatives and others which are constituted and traded in such a manner as to give rise to regulatory issues comparable to traditional financial instruments. The topic of commodity derivatives can be found in the Article 57 of MiFID II and it was put in place in order to avoid abusive behaviour on the market and to support orderly pricing and settlement conditions. It has to prevent the market from distorting positions.[42] Moreover, it has to ensure convergence between prices of derivatives in the delivery month and spot prices for the underlying commodity, without prejudice to price discovery on the market for the underlying commodity.[43]

According to the Article 57 of MiFID II, position limits are supposed to clarify quantitative thresholds for the maximum size of a position in a commodity derivative that persons can hold. The way of determining position limits will be specified by the ESMA. This methodology will have to consider the maturity of the commodity derivative contracts, the deliverable supply in the underlying commodity, the overall open interest in that contract and the overall open interest in other financial instruments with the same underlying commodity, the volatility of the relevant markets, including substitute derivatives, and the underlying commodity markets, the number and size of the market participants, the characteristics of the underlying commodity markets, including patterns of production, consumption, and transportation to market, and the potential development of new contracts.[44]

Article 58 of MiFID II clarifies the requirements regarding positions reporting in terms of commodity derivatives. Investment firms or market operators operating a trading venue and trading commodity derivatives, emission allowances, or derivatives shall publish a weekly report with the aggregate positions held by different categories of persons for the different commodity derivatives, emission allowances, or derivatives. At the

[42] MARKOVIČ, P. et al. *Manažment finančných rizík podniku: Implementácia derivátových kontraktov*. 1. vyd. Bratislava: Iura Edition, 2007. 383 p. ISBN 978-80-8078-132-3.

[43] Article 57 of the *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 EU L 173, 2014-06-12, pp. 349-496.

[44] Article 57 of the *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 EU L 173, 2014-06-12, pp. 349-496.

same time, they are asked to specify the number of long and short positions by such categories, changes thereto since the previous report, the percentage of the total open interest represented by each category, and the number of persons holding a position in each category. In this respect, the ESMA shall proceed to a centralised publication of the information included in those reports.[45]

Conclusion

The study aims to answer the question as to what new points the MiFID II regulatory package is bringing to the investment business. It tries to figure out the main points to be considered for implementation of relevant issues. As the paper is focusing on changes that the new regulatory package is bringing to investment banking, it may be worth asking the question what it is taking out from the investment business in Europe.

Investor protection has been increased under the MiFID II and the regulatory requirements have become stricter. The major consequence of the new MiFID II regulation consists of costs for entities to implement all relevant requirements in order to fully comply with new regulatory matters. The ratio between costs and income from the MiFID II impacted business seems to be crucial in order to determine if it is still profitable for specific investment firms which include banks to provide investment services, activities, and ancillary services, as stated in Annex I of MiFID II.

The question of investor protection is relevant in the investment business as this business implies certain risk. Speaking about risk from the perspective of investment firms, MiFID II may result in the disappearance of smaller investment firms and so possibly harm the competition in the European market.

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[45] Article 58 of the *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 EU L 173, 2014-06-12, pp. 349-496.

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JUDr. Filip Oller

Ministry of Transport, Construction and Regional Development
of the Slovak Republic
Námestie slobody 2902/6
810 05 Bratislava – Staré Mesto
Slovak Republic
filip.oller@gmail.com