Part I General Aspects, 1 Who’s Afraid of MiFID II?: An Introduction
Danny Busch, Guido Ferrarini

From: Regulation of the EU Financial Markets: MiFID II and MiFIR
Edited By: Danny Busch, Guido Ferrarini

Content type: Book content
Product: Financial Law [FBL]
Published in print: 12 January 2017
ISBN: 9780198767671

Subject(s):
Enforcement — Investment business — Regulated activities — Supervision
1 Who’s Afraid of MiFID II?

An Introduction

I. Introduction 1.01
   1. General 1.01
   2. From ISD to MiFID I 1.04
   3. From MiFID I to MiFID II 1.07
   4. The Term ‘Investment Firm’ 1.08

II. Investment Firms and Investment Services 1.14
   1. Scope and Exemptions 1.14
   2. Governance of Investment Firms 1.15
   3. The Duty to Act in the Client’s Best Interest 1.16
   4. Product Governance and Product Intervention 1.19
   5. Independent and Non-Independent Advice 1.20
   6. Conflicts of Interest 1.21
   7. Inducements 1.22
   8. Agency and Principal Dealing 1.23
   9. Third-Country Investment Firms 1.24

III. Trading 1.29
   1. Governance and Organization of Trading Venues 1.29
   2. The New Transparency Regime for Trading 1.30
   3. SME Growth Markets 1.33
   4. Dark Pools 1.34
   5. Derivatives Trading and the New Mandatory Trading Obligation 1.35
   6. Commodity Derivatives 1.40
   7. Algorithmic Trading and High-Frequency Trading 1.42
   8. MiFID II and Equity Trading Regulation: a US Perspective 1.44

IV. Supervision and Enforcement 1.45
   1. Public Enforcement of MiFID II 1.45
   2. The Private Law Effect of MiFID I and MiFID II 1.46

V. The Broader View and the Future of MiFID 1.48
   1. MiFID II and Investor Protection: Picking Up the Crumbs of a Piecemeal Approach 1.48
I. Introduction

1. General

1.01 Investment firms and regulated markets have been closely regulated by the EU Markets in Financial Instruments Directive (MiFID I), the MiFID I Implementing Directive, and the MiFID I Implementing Regulation since 1 November 2007.1 MiFID I and the MiFID I Implementing Directive have been transposed into national legislation in the various Member States of the European Union (EU) and the European Economic Area (EEA). Naturally, the MiFID I Implementing Regulation has not been transposed into national law. The regulation has direct effect and, under European law, may not therefore be transposed into national law. MiFID I aims to provide a high level of harmonized investor protection, financial market transparency, and greater competition between trading venues.

1.02 On 3 January 20182—some ten years later—the MiFID I regime will be replaced by MiFID II, which comprises, among other things, a Directive (MiFID II), the Markets in Financial Instruments Regulation (MiFIR), and a truly impressive number of implementing measures, commonly referred to as Level 2 legislation.3 MiFID I may have the reputation of being strict, but MiFID II/MiFIR tightens the reins even more. It is not hard to guess the reason: the financial crisis has also revealed gaps in the MiFID I legislation, notably in investor protection, as well as shortcomings in the functioning and transparency of financial markets. The MiFID II/MiFIR regime will have a major impact on the financial sector in Europe.

1.03 This book aims to analyse and discuss the main changes and new provisions introduced by MiFID II/MiFIR. The book chapters are grouped in a thematic way, covering the following areas: (i) investment firms and investment services, (ii) trading, (iii) supervision and enforcement, and (iv) the broader view and the future of MiFID II/MiFIR. This chapter provides a summary and overview of the chapters of this book. But before doing so, we will first briefly outline the history of the European regulation of investment firms and regulated markets, followed by a treatment of the central term ‘investment firm’.

2. From ISD to MiFID I

1.04 The European regulation of investment firms and regulated markets started not with the MiFID I regime but even earlier. 1993 saw the adoption of the Investment Services Directive (ISD).4 The ISD introduced a rather elementary scheme, which was fairly soon found to have deficiencies. The ISD provided for insufficient harmonization, weak investor protection, and limited competition between trading venues. In the view of lawmakers, the MiFID I regime was intended to rectify these shortcomings.5

1.05 It is hardly surprising that the ISD provided insufficient harmonization since it was only intended to provide minimum harmonization. This meant that the Member States were able to introduce stricter rules, thereby detracting from the concept of a level playing field.6 In the interests of the general good, the Member States could also create obstacles for investment firms from other Member States.7 And this actually happened in many Member States, especially in relation to conduct of business rules (i.e. the rules on how investment firms should treat their clients). Investor protection was also inadequate. This was mainly because the ISD did not cover all services and financial instruments. Indeed, the ISD did not even cover such an essential service in practice as investment advice, and commodity derivatives did not come under the ISD because they were not treated as financial instruments. This posed risks for investors and jeopardized the efficient and stable
operation of financial markets. MiFID I has largely addressed these points. Unlike the ISD, MiFID I for the most part provides for maximum harmonization so that the Member States may not introduce supervision rules that are more strict or less strict than the MiFID I regime. Moreover, MiFID I covers investment advice, and the definition of ‘financial instrument’ has been expanded in such a way that it now also includes commodity derivatives.\(^8\)

**1.06** Finally, as various rules had gradually become outdated, the ISD no longer provided an answer to changed market structures such as the advent of alternative trading venues. Alternative trading venues fulfil the same economic functions as regulated markets and came across to Europe in the 1990s from the United States, where they had been around for longer. In the 1990s alternative trading venues tended to be based in London. Regulated markets are, in common parlance, stock markets. The purpose of both established stock markets and alternative trading venues is to marry up supply and demand for financial instruments in a multilateral setting. It should be noted that financial instruments listed on a stock market can be traded not only on the stock market concerned but also on other stock markets or through an alternative trading venue. During the negotiations on the ISD, free competition between the established (at that time still mainly national) stock markets and other stock markets or alternative trading venues was already a reality.\(^9\) The northern and southern Member States took diametrically opposed positions on this subject during the negotiations. The United Kingdom, Germany, Luxembourg, the Netherlands, Ireland, and Denmark were in favour of free competition between trading venues because competition reduces trading costs. As they saw it, investors only stood to benefit from this. But France, Italy, Spain, Portugal, Greece, and Belgium saw things differently and pointed to the risk of market fragmentation. If an order in a financial instrument could be executed on a multitude of trading venues, this would mean that there would be insufficient liquidity at each trading venue to establish efficient price formation. And this would actually be to the disadvantage of investors. Naturally, national interests also played a role here. The southern Member States were undoubtedly fearful that the position of their own national stock markets would be weakened. They preferred not to see trade ebbing away to alternative trading venues in London. Conversely, the United Kingdom had for this very reason much less difficulty in accepting the concept of free competition between trading venues. Whatever the case, the two sides failed to reach agreement on this during the negotiations on the ISD. As a compromise, the so-called optional concentration rule was included in the ISD.\(^10\) This rule meant that it was up to the Member States themselves to decide whether retail orders in financial instruments should necessarily be executed by sending them to the stock markets, which were still mainly national. Hardly surprisingly, the northern Member States did not make use of this option, unlike the southern Member States.\(^11\) However, the issue was unexpectedly resolved during the negotiations on MiFID I. The optional concentration rule was abolished, and since 1 November 2007 there has been free competition between stock markets and alternative trading venues throughout the EU/EEA. Judging by the figures, this competition has become fairly well established in recent years.\(^12\)

3. **From MiFID I to MiFID II**

**1.07** MiFID I is a major advance on the ISD. Indeed, MiFID I has justifiably been called the ‘core pillar of EU financial market integration’.\(^13\) Nonetheless, as noted at the start of this chapter, the financial crisis has been one factor that has exposed major gaps in investor protection and shortcomings in the operation and transparency of financial markets. As a result of these gaps and shortcomings, strenuous efforts have been made since 2010 to carry out a thorough review of the MiFID I regime.\(^14\)
4. The Term ‘Investment Firm’

1.08 We have already used the term ‘investment firm’ on a number of occasions. Unlike terms such as ‘insurer’ or ‘bank’, ‘investment firm’ is little used in common parlance, and even in the financial press it is rarely encountered. Moreover, it is often confused with the term ‘investment fund’. So there is more than sufficient reason to devote a section to clarify this central term.

1.09 Under MiFID I and MiFID II, an investment firm is defined as an entity that provides investment services and/or performs investment activities. Both the services and the activities relate by definition to financial instruments. The investment services and activities are (1) reception and transmission of orders in financial instruments; (2) execution of orders in financial instruments on behalf of clients; (3) portfolio management; (4) investment advice; (5) underwriting or placing of financial instruments with and without a firm commitment basis; (6) dealing on own account; and (7) operation of a multilateral trading facility (MTF). MIFID II adds an additional activity to the list, namely the operation of an organized trading facility (OTF). For the sake of clarity, it should be noted that although the operator of a regulated market is not an investment firm, it is subject to MiFID I and MiFID II, albeit to a different set of rules than those applicable to investment firms.

1.10 It should be realized in this connection that the categories listed above can overlap. When providing a service, an individual portfolio manager or an investment adviser will often execute orders in financial instruments on behalf of the client (although there are also portfolio managers and investment advisers who leave the execution of orders on behalf of clients to other parties). In short, individual portfolio management and investment advice may include the power to execute orders on behalf of clients.

1.11 If a given financial product is not a financial instrument, it cannot give rise to an investment service or activity and the relevant entity is not an investment firm in relation to that product and is not subject to the MiFID I and MiFID II regime for investment firms. It should be noted, incidentally, that the term financial instrument is a fairly broad concept. It includes not only equities and bonds but also interest rate swaps and many other derivative products. Under MiFID II the definition of financial instrument has been broadened still further.

1.12 In any event, the basic rule is that an investment firm needs authorization granted by the home Member State’s competent authority in order to act as such. Once an investment firm has this authorization, it can provide investment services and perform investment activities throughout the entire EU/EEA, insofar as these services and activities are covered by the authorization (the so-called European passport). To be eligible for an authorization, an investment firm must fulfill extensive requirements. These requirements also apply after the investment firm has obtained authorization. It follows that investment firms must comply with the conditions for initial authorization at all times. Moreover, they must also comply with any additional requirements that may be imposed.

1.13 Credit institutions authorized under Directive 2013/36/EU can also provide investment services and/or perform investment activities, in which case they are largely subject to the same MiFID I and MiFID II rules applicable to investment firms.

II. Investment Firms and Investment Services

1. Scope and Exemptions
1.14 In Chapter 2, Lieverse discusses the main changes of the scope of MiFID II, in comparison with MiFID I. MiFID II introduces several changes to the scope of the supervision of investment firms and some other business related to the investment services industry, including data reporting service providers. The list of investment services has been extended by adding the operation of an OTF. Also, the revision and—in respect of some items—extension of the definition of ‘financial instrument’ has an impact on the scope of MiFID II supervision, including emission allowances. In addition, advisory and distribution services in respect of structured deposits by investment firms and credit institutions have been brought within the scope of MiFID II. Furthermore, supervision comparable to the MiFID II system is being introduced for insurers and intermediaries in respect of investment-based insurance products. At the same time, the scope of some of the exemptions to MiFID II is revised, with an impact in particular for trading on own account. Trading on own account through high-frequency algorithmic trading techniques is brought within the scope of MiFID II, and the broad exemption for traders in commodities derivatives has also been limited. As a result, the scope of MiFID II is considerably broader than MiFID I. This has an effect beyond the applicability of MiFID II regulation, as currently the prudential requirements are as a starting point also linked to the MiFID II qualification, though with specific exemptions. In addition, the concept of linking prudential supervision to the MiFID II qualification, rather than to the prudential risk profile of the underlying services and activities, is subject to review and reconsideration.

2. Governance of Investment Firms

1.15 In Chapter 3, Binder discusses the governance of investment firms. In response to widespread concerns about the quality of governance arrangements in financial intermediaries as a source of systemic risk, the revised framework for the regulation of investment services in the EU has not just reinforced the governance requirements that have been in place for a long time, but has significantly increased their complexity and intensity. Investment firms, which are subject to both the Capital Requirements Directive (CRD) IV and MiFID II, now have to comply with a wide range of regulatory requirements, covering board structure and composition, as well as individual duties of board members and their remuneration, general organizational and risk management arrangements, and the supervisory scrutiny of shareholders and owners with qualifying holdings. The author concludes that the underlying policy (to address systemic implications of financial intermediation irrespective of the business model) is certainly consistent, but that the equal treatment of banks and investment firms under broadly identical regulatory frameworks (albeit with additional requirements imposed by MiFID II) is nonetheless questionable in view of the diversity of existing business models and activities. Starting with an analysis of the historical emanation of the new approach and the underlying policy, the author seeks to identify potential weaknesses and implications for its implementation.

3. The Duty to Act in the Client’s Best Interest

1.16 In Chapter 4, Enriques and Gargantini analyse the scope, contents, and implications of MiFID II’s new framework regarding the duty to act in the client’s best interest. The authors analyse the duty as an autonomous source of obligations for investment firms and as a guidance principle for both EU bodies in charge of implementing MiFID II and judges and supervisory authorities interpreting more specific duties. The authors also discuss the implications of extending the duty to intrinsically at-arm’s-length activities such as dealing on own account and self-placement.

1.17 MiFID II confirms, in line with its predecessors, that investment firms must act in accordance with the best interests of their clients. Besides being an overarching principle for firms’ professional conduct, the duty to act in the client’s best interest is further specified by more detailed provisions within the body of MiFID II, and therefore plays a role in their interpretation. Rules concerning the management of conflicts of interest, including
at the level of staff remuneration practices, limitations to inducements, and best execution are just a few examples of obligations aimed at ensuring that clients’ interests are pursued even when firms’ incentives may be tainted. The ‘best interest’ principle may have direct application as well, thus grounding firms’ liability even in cases where no specific rule of conduct is violated.

1.18 Although the general principle set forth by Article 24(1) is not new, MiFID II further specifies its implications and, overall, enhances its effects: it does so by introducing new specific rules of conduct implementing the ‘client’s best interest’ standard and by broadening its scope of application. For instance, new provisions ensure that firms pursue clients’ interests both during product distribution and before customers are approached: MiFID II mandates a thorough understanding of the marketed financial instruments and of clients’ needs when financial instruments are offered or recommended, and requires firms to design financial instruments in the light of the characteristics of the target groups at the early stage of product manufacturing. At the same time, the expansion of the regulated activities brings new business areas within the purview of the ‘best interest’ standard: this is particularly the case with placement of firms’ own products on the primary market (self-placement), now explicitly included in the list of investment services and activities.

4. Product Governance and Product Intervention

1.19 In Chapter 5, Busch analyses and discusses the product governance and product intervention rules introduced by MiFID II/MiFIR. According to the author, the combination of these two approaches designed to exclude harmful products from the market is a major step forward in investor protection. On the other hand, complying with the product governance rules will entail costs for the firms concerned. They will have to put in place the requisite internal procedures and there will be a statutory duty for the firm developing the product and the firm distributing it to exchange a considerable volume of information. All in all, the author believes that these extra costs (which will undoubtedly be discounted in the cost price of the product) are acceptable. In any event, they are dwarfed by the social costs caused by the marketing of harmful financial products (e.g. interest rate swaps sold to small and medium-sized enterprises in many European countries). The author argues that MiFID II’s introduction of both product governance rules and product intervention rules is no more than common sense. It would be naive to think that product governance rules could in practice guarantee that harmful products are no longer marketed.

5. Independent and Non-Independent Advice

1.20 In Chapter 6, another noteworthy innovation is discussed by Giudici: MiFID II (unlike MiFID I) draws a distinction between independent and non-independent advice. The author submits that the quickest policy indication for increasing households’ trust in financial markets, to the benefit of the economic system, seems to be the offer of professional financial advice on affordable terms. The problem is how to convince investors to pay for advice, and how to protect investors who do not want to pay for conflicted advice and for hard sell under the guise of personal recommendation—an area where MiFID I has not performed well. MiFID II’s answer is to pose a new set of information duties on financial advisors with the clear intention of nudging investors towards independent, fee-only advice. The intention is good. However, the author argues that the new regime raises many important issues, among which are: the ambiguity of the ‘independent’ suit, which can be taken or demised by investment firms from time to time and from client to client; the interaction between the product governance regime and the suitability assessment; the regulatory inconsistency that is emerging between investment advice and portfolio management; and the potential costs of the written statement of suitability.
6. **Conflicts of Interest**

1.21 In Chapter 7, Grundmann and Hacker analyse and discuss the issue of conflicts of interest in the ambit of services regulated by MiFID. The authors do so mainly with respect to the MiFID II regime, but take the MiFID I regime as a background because it has been more abundantly discussed and because the largest part of the basic structure and also many single solutions have remained unchanged. The chapter combines (several) legal and social science theories with an analysis of the substantive law solutions, and presents them in an evolutionary perspective, but also with a focus on a more detailed analysis of the status now reached. The authors argue that the legislature did not take sufficient care in specifying the different approaches which (may have) influenced the substantive law solutions found, and did not even specify clearly the interests involved. The authors further argue that it is best to expose the regime by segregating the single main stages of an investment services relationship and approaches which have been used (and solutions which have been found). Such segregation is all the more important as solutions and approaches used at the different stages are indeed highly heterogeneous in kind. The authors do not criticize, but clarify this—it may well be that the factual background of the different stages and situations calls for such heterogeneity in regulatory approach (which will be discussed for the single situations). For presenting this programme, the authors first expose the foundations—(i) the most important theoretical approaches to a regulation of conflicts of interest, and (ii) the legislative bases (and history)—and then proceed to analyse the five different stages and situations (and, in addition, linked contracts) step by step. The authors always start by characterizing the type of approach taken in the legislative regime, then move on to the main features of innovation in the transition from MiFID I to MiFID II, before finally discussing in greater detail the substantive solution found in MiFID II.

7. **Inducements**

1.22 In Chapter 8, Silverentand, Sprecher, and Simons analyse and discuss the MiFID II inducement rules. During the negotiations on MiFID II, it became clear that inducements were a topic on which there was no easy agreement between the Member States. Where certain Member States pressed for a total ban on inducements, other Member States were unwilling to impose such strict rules. As is not uncommon in these situations, the political compromise that was reached was to allow for deviating rules by those Member States that wished to see stricter rules. Allowing for this may be regarded as counter to the general trend set by the European legislator to create less room for Member State options by creating ‘single rulebooks’ and an increase in the use of regulations. The authors conclude that it is disappointing to see that on such an important topic, the European market will continue to have rules that deviate per Member State. The Dutch legislator has already indicated that it will make use of the (continued) room for ‘gold plating’, and it can according to the authors be expected that other Member States where stricter rules apply will do the same, leaving an un-level playing field for investment firms regarding the use of inducements.

8. **Agency and Principal Dealing**

1.23 In Chapter 9, Busch focuses on the question of whether allowing the extent of the protection afforded to an investor under MiFID to be largely dependent on the distinction between dealing on own account on one hand and trading on behalf of the client (and other forms of investment service) on the other is justified. The author submits that this question must be answered in the negative. An investor may reasonably expect the investment firm used by him to look after his interests adequately and thus to observe certain duties of care towards him. The investment firm is, after all, ideally placed to use its expertise. Its fund of knowledge is bound to be superior to that of an investor, particularly a retail investor. Nor is this any different where the investment firm acts purely as the investor’s contractual counterparty. In such cases, the investor is reasonably entitled to expect the investment
firm to observe the same duty of care that would apply if it were providing an execution-only service. Moreover, the distinction between dealing on own account (principal dealing) on one hand and trading on behalf of the client (and other forms of investment service) on the other is tenuous, arbitrary, and easy to manipulate. This is all the more so where a contractual clause providing that an investment firm acts solely as contractual counterparty is claimed to apply even where an employee of the investment firm advises the investor, contrary to the terms of the agreement. According to the author, MiFID II provides no practicable criterion either. To achieve an adequate level of investor protection MiFID II resorts to the artifice of reclassifying certain types of dealing on own account as acting on behalf of the client. Finally, both the UK Government (in response to the Kay Review) and the Dutch Supreme Court take the view that duties of care must also apply where an investment firm acts solely as an investor’s contractual counterparty. Under a future MiFID III, an investment firm which acts solely as contractual counterparty should be required to observe the same duty of care as applies in the case of the investment service of execution of orders on behalf of the client.28

9. Third-Country Investment Firms

1.24 In Chapter 10, Busch and Louisse analyse and discuss the MiFID II/MiFIR rules for third-country investment firms (i.e. investment firms established outside the EU/EEA). Under MiFID II the position of third-country firms will no longer be a purely national matter. MiFID II now itself sets the parameters. But, as the authors explain, the legislation is unfortunately complex and does not provide for full harmonization. The Commission and the Member States found it hard to reach agreement on this point. The phenomenon of differing national regimes is therefore not precluded even under MiFID II. The fact that MiFID II regulates the position of third-country firms reflects a European trend. The European Market Infrastructure Regulation (EMIR), the CRA Regulation, and the AIFMD all deal with the position of parties established in a third country. These may be CCPs, CRAs, AIFMs, or depositaries.

1.25 MiFID II/MiFIR introduces a common regulatory framework that should harmonize the existing fragmented framework for the provision of services by third-country firms, ensure certainty and uniform treatment of third-country firms accessing the EU/EEA, ensure an assessment of effective equivalence by the Commission, and provide for a comparable level of protection to clients in the EU/EEA receiving services from third-country firms.

1.26 Articles 46–49 MiFIR (the MiFIR third-country regime) regulate the provision of investment services to eligible counterparties and per se professional clients and performance of investment activities by third-country firms following an equivalence decision by the Commission. Upon adoption of such equivalence decision, a third-country firm can register itself with ESMA. Once a third-country firm has been registered by ESMA, it may provide investment services or perform investment activities to eligible counterparties and per se professional investors throughout the EU/EEA. Member States may not impose any additional requirements on such third-country firms in respect of matters covered by MiFID II/MiFIR and CRD IV/CRR. In the absence of an equivalence decision in relation to a third country, the national regimes of the Member States continue to apply.

1.27 The provision of investment services to retail and opt up professional clients and performance of investment activities through the establishment of a branch is regulated in Articles 39–43 MiFID II (the MiFID II third-country regime). Under the MiFID II third-country regime, Member States have the option to require the opening of a branch by a third-country firm wishing to provide investment services and/or perform investment activities (with or without ancillary services) in a Member State to retail clients or to opt up professional clients (i.e. clients who have obtained professional client status by opting up).
If a Member State requires the opening of such a branch harmonized requirements will apply. Otherwise, the national regimes of the Member States continue to apply.

1.28 Although the basics of the third-country regime under MiFID II/MiFIR seem to be set, the authors show that the devil is in the detail. There is still a considerable lack of clarity in relation to the scope of the MiFID II/MiFIR’s third-country regime, as in where it concerns investment activities, and activities other than investment services and investment activities (such as selling and advising in relation to structured deposits), or the initiative test. In addition, the concurrence between MiFID II and MiFIR, if a third-country firm provides investment services eligible counterparties and retail clients, raises interesting questions that are not easily answered.

III. Trading

1. Governance and Organization of Trading Venues

1.29 In Chapter 11, Ferrarini and Saguato analyse the governance and organization of trading venues. The authors show that MiFID II brings modest changes to the EU landscape of trading venues. The newly introduced Organized Trading Facilities (OTFs) are going to be the reference venues for a significant portion of the derivatives trading in years to come. The regulated markets (RMs) and Multilateral Trading Facilities (MTFs) regimes have been aligned, and specific provisions strengthen the governance of the venues and their operators. However, market dynamics are already challenging the MiFID II regulatory framework for the governance and organization of trading venues. Trading venues have developed over the last twenty years into Financial Markets Infrastructures (FMI) groups that provide both trading and post-trading services. These new conglomerates test the capacity of the current regulatory and supervisory regime of financial markets—and MiFID II itself—to oversee their activities and to guarantee competition and stability in the trading and post-trading industry. MiFID II does not explicitly take FMI groups into account—trading venues are regulated as individual entities, which may or may not be operated within a group. In MiFID II, only three sets of rules address, to varying degrees, some of the potential risks underlying FMI groups: (i) conflicts of interest between firms operating and RMs, MTFs, and OTFs; (ii) transparency of ownership of trading venues and suitability of trading venues’ shareholders; and (iii) non-discriminatory access to trading and post-trading services. However, the prudential regulation and supervision of the FMI group has not been included in the MiFID I review process. The authors conclude that this regulatory gap might be a threat to the stability of financial markets, and regulators should consider a regulatory intervention to fill it. The experience of the regulatory and supervisory colleges of CCPs under EMIR and the regulatory framework of the financial conglomerates Directive could be two possible ways to strengthen the oversight of FMI groups.

2. The New Transparency Regime for Trading

1.30 In Chapter 12, Moloney outlines the main features of the extensive new transparency regime which will apply to trading in a wide range of asset classes under MiFIR. By contrast with MiFID I, which limited transparency requirements to the equity markets and which contained extensive exemptions and waivers, MiFIR adopts a maximalist approach to transparency. The most extensive transparency requirements apply to the three forms of ‘trading venue’ for multilateral trading which are established under the MiFID II/MiFIR venue classification system (RM, MTF, and OTF). Bilateral/OTC trading between counterparties is subject only to post-trade transparency requirements. Overall, MiFIR’s regulatory design has been shaped by a driving concern to protect liquidity, particularly in non-equity asset classes. Indeed, exemptions, waivers, suspensions, and calibrations, designed to protect liquidity, are a recurring feature of the new transparency regime. The pre-trade equity/equity-like transparency regime is subject, for example, to a series of
waivers designed to allow venues to support ‘dark’ trading, given the efficiencies which dark trading can bring, notably for institutional investors and for market liquidity generally.

1.31 Once the Level 2 process which governs the adoption of administrative rules is completed, the MiFIR transparency rulebook will form a regulatory regime of vast breadth and depth. But operational supervisory decision-making by national supervisors will, in addition, become subject to EU-level controls and processes. The waivers which are available from the transparency requirements for equity and non-equity trading can be regarded as the key battleground on which national supervisors (and the Member States) will seek to protect national territory, in that the waivers afford national supervisors the possibility to apply tailored treatment to distinct national trading systems and practices.

1.32 In one of the key changes from MiFID I, ESMA is now empowered to oversee national supervisory decision-making with respect to equity and non-equity pre-trade transparency waivers. Under MiFID I, waiver decisions in relation to the equity transparency rules are currently at the discretion of national supervisors, but under voluntary arrangements proposed supervisory waiver decisions are notified to ESMA, which then adopts a common position across its member supervisors on the waiver. This informal process has now been formalized. The author submits that while the new regime will have significant market-shaping effects, it will also prove revealing as to the effectiveness of the administrative governance apparatus which currently supports EU financial governance. In particular, the new transparency regime is exposing weaknesses in regulatory administrative governance, notably with respect to how the EU deals with uncertainty. Specifically, the absence of a power to suspend administrative rules where they prove to have destabilizing effects may prove a significant challenge to the effectiveness of EU financial governance, given the uncertain impact of MiFIR on financial markets.

3. SME Growth Markets

1.33 In Chapter 13, Veil and Di Noia analyse and discuss SME Growth Markets, introduced under MiFID II as an important strategy to improve access to finance for SMEs in Europe. SME Growth Markets should be more flexible than regulated markets. However, the authors submit that this will not be the case. The regime for SME Growth Markets will consist of strict rules about insider trading and market manipulation which are subject to supervision by NCAs. These parts of the regime are important to ensure investor confidence. It is also convincing to protect investors by a disclosure regime ensuring the publication of price-relevant information on SME Growth Markets. However, the authors argue that it is neither necessary nor recommendable to apply the respective disclosure obligations (as well as the similar regime for insiders’ lists and the identical one for managers’ transactions) under the MAR. Instead, a system based on current event reports is sufficient in order to tackle information asymmetries on SME Growth Markets. The authors conclude that the disclosure regime for SME Growth Markets in Europe should be re-assessed with the aim of allowing market operators to experiment with alternative disclosure obligations on SME Growth Markets.

4. Dark Pools

1.34 In Chapter 14, Gomber and Gvozdevskiy focus on the concept of dark trading in the context of MiFID II. This is analysed against the background of the MiFID I regulation and its economic consequences for European equity markets. Dark trading implies orders with partial or missing pre-trade transparency, meaning that these orders are hidden from the rest of the market. Dark pools of regulated venues and in (un-regulated) OTC markets allow institutional investors to execute large blocks of shares in one lot, reducing information leakage, diminishing market impact, and providing price improvements. MiFID II aims to increase market transparency and to bring trading of financial instruments into regulated platforms. Extending the waivers introduced by MiFID I, the new Directive announces the double volume cap regime. The first cap of the mechanism restricts the usage of waivers by
individual trading venues if the proportion of total value traded under negotiated transactions and reference price waivers together exceeds 4 per cent of total trading volume. The second cap suspends all trading venues across the Union from trading under negotiated transactions and reference price waivers, if the cumulated proportion of total value traded under these waivers across the Union exceeds 8 per cent of total trading volume. And additional trading obligation of shares will reduce the extent of OTC trading in Europe. Some market participants and trading venues recently introduced MiFID II-ready solutions preventing dark executions from being subject to the double volume cap regime either by classifying the orders as large in scale or by introducing trading systems based on auction market models. These models and functionalities, which already anticipate the future MiFID II regime, are also discussed.

5. Derivatives Trading and the New Mandatory Trading Obligation

1.35 In Chapter 15, Stegeman and Berket analyse and discuss the new mandatory trading obligation for derivatives provided in Title V of MiFIR. The authors conclude that time will tell whether the new rules discussed in this chapter will impact on the derivatives markets as they stand today, and, if so, to what extent and in what ways.

1.36 The opinions on whether the trading obligation will have any effect are very fragmented. This makes it hard to predict the exact consequences it may have. However, looking at the US, activity and liquidity in the USD and EUR plain vanilla IRS markets have increased following the Dodd–Frank trading mandate, according to a Bank of England Staff Working Paper. Furthermore, it is concluded that the associated execution costs in these markets are significantly reduced, the causes of this reduction likely to be the shortening in dealer intermediation chains and more competitive pricing by dealers. Both are potentially attributed to mandatory exchange trading, as the results of the research suggest that inter-dealer market activity has reduced following the trading mandate entering into force. However, the researchers could not scientifically prove a causal link between the trading mandate and the reduction in inter-dealer trading. As such, the full impact of the trading mandate remains uncertain.

1.37 With respect to the clearing obligation and the rules on the timing of acceptance for clearing (STP obligation) the authors expect the impact to be relatively limited as they seem to be in accordance with current market practices, or at least not too far off. However, it remains to be seen whether the mandatory reduced timeframes increase the risk of errors.

1.38 With the portfolio compression rules under MiFIR the European legislator continues stimulating portfolio compression by regulation. The light-touch regime seems to strike the right balance between, where possible and appropriate, encouraging parties to compress their portfolios on one hand and increasing transparency for the entire market on the other hand. According to the authors it is therefore conceivable that portfolio compression will remain a much used exercise in the foreseeable future.

1.39 When comparing the new obligations, according to the authors the rules relating to indirect clearing have the most velar impact on the current market practice. Since, different from the indirect clearing rules for OTC derivatives under EMIR, indirect clearing is commonly seen in the ETD space, these rules will definitely impact these existing client clearing processes.

6. Commodity Derivatives

1.40 In Chapter 16, Sciarrone Alibrandi and Grossule analyse and discuss the MiFID II/ MiFIR regulation of the commodity derivatives sector. The authors submit that this sector is one of the areas most affected by the financial markets reform process, particularly in the MiFID I review. Under the G20 mandate, EU policymakers issued specific provisions to
increase transparency, tackle the turbulences affecting commodity markets, and curb the negative effects of speculation.

1.41 This chapter analyses the position limits regime establishing limits on ex ante positions related to all commodity derivatives and prohibiting participants from holding contracts beyond a certain limit. Furthermore, this chapter deals with the new rules amplifying the regulatory and supervisory powers of ESMA, of national competent authorities (NCAs), and trading venues, introducing a range of interventionist tools that can affect operators’ investment business. The chapter also stresses the need to introduce a specific regulation depending on different commodity derivatives (e.g. energy and food). The main provisions and the specific technical standards are analysed, paying particular attention to controversial measures such as the definition of the ancillary activities, the methodology to calculate the position limits, and the authorities’ new powers (especially in the field of product intervention).

7. Algorithmic Trading and High-Frequency Trading

1.42 In Chapter 17, Conac analyses the MiFID II rules on algorithmic trading (AT), including high-frequency trading (HFT). The author argues that AT raises serious issues of volatility and systemic risk while HFT raises issues of systematic front-running of investors. However, there are serious differences of opinion within the EU as to the benefits and risks of those two trading techniques, and especially of HFT. Therefore, MiFID II takes a technical approach mostly focused on prevention of a repeat of the 2010 Flash Crash and some provisions on market abuse.

1.43 Since the MiFID II will not be implemented before 2018, the ESMA 2012 Guidelines will remain the most effective regulation to frame the development of HFT. The author submits that this reveals the usefulness of having ESMA adopting Guidelines in order to tackle market developments with relative speed. However, since the EU legislator decided not to tackle HFT strongly, and since implementation of the Directive is still far away, it is probable that some legislators and supervisors will do it themselves. The successful case of enforcement in France is a sign of this possible trend. Therefore, regulation by prosecution of market abuse by HFT traders could lead to a de facto ban of HFT in some Member States. The author argues that this would be a huge cost for supervisors as they would need to allocate scarce resources to this topic, which means that only the most motivated supervisors will do it.

8. MiFID II and Equity Trading Regulation: a US Perspective

1.44 In Chapter 18, Fox provides a US perspective on the MiFID II equity trading regulation. The author concludes that a comparison of the EU and US market structure rules, and the concerns that generated them, suggests three key differences. Relative to the United States, the EU shows (i) more concern with having an effective price-formation process, (ii) more concern with the possibility that HFTs contribute to price instability and engage in market abuse, and (iii) less concern with promoting competition among trading venues. These differences have characterized the MiFID I era and are reflected in MiFID II as well, although MiFID II does evince somewhat greater concern about competition among trading venues than was true before.

IV. Supervision and Enforcement

1. Public Enforcement of MiFID II

1.45 In Chapter 19, Gortsos provides a systematic presentation, analysis, and assessment of the MiFID II provisions (Articles 67–88) on supervision, enforcement, and cooperation by competent authorities. The author addresses the role of Member States’ competent authorities within the system of the MiFID II, with particular emphasis on the competent authorities’ supervisory powers, their power to impose administrative sanctions and
measures, as well as criminal sanctions and redress procedures. Cooperation arrangements between Member States’ competent authorities, the obligation to cooperate with the ESMA, and cooperation with third countries are addressed as well. Finally, the rules are briefly assessed on the basis of three (out of the five) elements pertaining to financial supervision, which, in the author’s view, are essential for the preservation of financial stability and the attainment of the other goals underlying (public) capital markets law and which are addressed by the provisions of the MiFID II: (i) micro-prudential supervisory effectiveness, (ii) the efficient and unobstructed exercise of competent authorities’ sanctioning powers, and (iii) the effectiveness of supervisory cooperation arrangements.

2. The Private Law Effect of MiFID I and MiFID II

1.46 In Chapter 20, Busch examines to what extent the civil courts are bound by MiFID I/ MiFID II under European law. In addressing this subject, the author discusses the following topics: (i) whether the civil courts may be less strict or stricter than MiFID I/MiFID II, (ii) whether the contracting parties may be less strict or stricter than MiFID I/MiFID II, (iii) whether there is any influence of MiFID I/MiFID II on the principle of ‘relativity’ or ‘proximity’ in the Member States where this is a requirement for liability in tort, (iv) whether there is any influence of MiFID I/MiFID II on proof of causation, (v) whether there is any influence on a contractual limitation or exclusion of liability, and (vi) whether the civil courts are obliged to determine of their own motion whether there has been an infringement of MiFID I/MiFID II (conduct of business) rules in disputes between investment firms and private investors.

1.47 The author concludes that the last word has not been spoken about the effect of MiFID I/MiFID II on private law. MiFID II is as unclear about this as MiFID I. Although the possible contours are somewhat clearer as a result of the judgments in the Genil and Nationale-Nederlanden cases, the EU Court of Justice has not yet explicitly answered the main questions. For more definitive answers it will be necessary to await the further judgments of the Court of Justice.

V. The Broader View and the Future of MiFID

1. MiFID II and Investor Protection: Picking Up the Crumbs of a Piecemeal Approach

1.48 In Chapter 21, Colaert clarifies the relationship between the MiFID II and several other closely related Directives, such as the Insurance Distribution Directive, the PRIIPs Directive, and the UCITS Directive. The interaction between different pieces of EU financial legislation becomes ever more important—and difficult.

1.49 The analysis reveals numerous inconsistencies and interpretation difficulties. The author argues that while some of the shortcomings are inherent to the EU piecemeal approach, other problems should and could have been avoided, by adopting a holistic approach of financial regulation and supervision.

2. Shadow Banking and the Functioning of Financial Markets

1.50 In Chapter 22, Wymeersch analyses and discusses shadow banking and the functioning of financial markets; that is, activities that are outside the regulatory perimeter of MiFID I and MiFID II/MiFIR. The author shows that financial activity that is taking place outside the traditional and often regulated financial sphere of the securities markets has become quite substantial and especially diverse. This segment is often designated as ‘shadow banking’—a misnomer. The activities to be classified under this characterization have been mapped by the Financial Stability Board, and include a wide variety of entities which either specialize in specific financial activities, or offer financial services as part of their overall product offer. The risks they create are essentially of a macro or ‘systemic’ nature, leading to major financial disruption and contagion. In the securities markets, this
activity is often indirectly regulated as part of the wider market regulation. For example, this is the case for the market in derivatives, or for the use of securitized instruments; for derivatives, certain trading venues have been mandated, not always with comprehensive results. The author submits that the post-trade sector may be a source of considerable risk: therefore OTC derivatives are subject to mandatory clearing in the CCP, while title security for most traditional securities will be organized within the Central Securities Depositories. The recent Securities Financing Regulation, dealing with repos and similar instruments, clarifies the position of investors that see their securities ‘re-used’ in a second collateral transaction, for which in the future their express consent will be necessary. The author concludes that, although thought to be on the border of the traditional securities systems, these matters and the related regulation have a considerable impact on the framing of certain classes of securities and may determine the safety of the overall system, including that of the final investor.

3. Investment-Based Crowdfunding: Is MiFID II Enough?

1.51 In Chapter 23, Ferrarini and Macchiavello explore the policy and regulatory issues generated by investment-based crowdfunding in Europe. First, the authors argue that crowdfunding raises serious investor protection concerns, particularly when directed to retail investors. As governments try to stimulate innovation and the formation of new enterprises, a trade-off is created between investor protection and economic growth. EU law and the laws of Member States try to solve this trade-off in different ways, as the authors show with reference to MiFID I and the laws of the UK, France, Italy, Spain, and Germany. Second, the authors focus on MiFID II and show that the new Directive, while enhancing investor protection in general and furthering harmonization, does not create all the conditions needed for the formation of a pan-European crowdfunding market. At the same time, MiFID II narrows the potential for exemptions under which some Member States have adopted special regimes for crowdfunding, therefore restricting the scope for an enabling approach to investment-based crowdfunding at the national level.

VI. Final Remarks

1.52 On the whole, this volume’s chapters show that MiFID II will have a major impact on the financial services sector. MiFID II introduces a veritable flood of new rules (not only at Level 1 but certainly also at Level 2) and tightens up certain aspects of existing rules.

1.53 Naturally, only time will tell whether the package of measures under MiFID II will have the desired effect and always allow the right balance to be struck between costs and benefits. And the question arises of whether compliance with the flood of new regulatory provisions is even possible.32

1.54 In any event, the Commission has recently indicated that it will pay more attention to the regulatory burden. Under the direction of Frans Timmermans, the Commission has developed an improved regulation programme: fewer new rules and more evaluation of existing rules.33 This is yet another real challenge.

1.55 It is also worth noting here that the Commission published a call for evidence on 30 September 2015. In the space of just six years the Commission has published no fewer than forty Directives and regulations relating to the financial markets with the aim of preventing another crisis. The Commission now wishes to examine whether the structure as a whole is consistent and whether any of the rules overlap or give rise to undesirable economic consequences. On 17 May 2016, the Commission published a summary of the 288 responses it had received. Overall, stakeholders did not dispute the reforms of recent years and many expressed support, highlighting the benefits of the new rules. But the Call for Evidence was
also welcomed as giving all interested parties the opportunity to assess the potential interactions, overlaps, and inconsistencies between different pieces of legislation.\textsuperscript{34}

\textbf{1.56} Finally, there is Brexit. A referendum was held on Thursday 23 June 2016, to decide whether the UK should leave or remain in the EU. Leave won by 52 per cent to 48 per cent.\textsuperscript{35} Only time will tell what this means for the financial sector in Europe and the UK financial sector in particular. However, it seems safe to assume that the UK will not formally leave the EU before MiFID II/MiFIR becomes binding on the financial sector in Europe. So Brexit should not delay a UK MiFID II implementation beyond the EU’s 3 January 2018 effective date.\textsuperscript{36}

\textbf{1.57} Whichever way you look at it, MiFID II will be a fact of life for the financial sector in Europe for the years to come.

\textbf{Footnotes:}


\textsuperscript{2} Initially, Directive 2014/65/EU, OJ L 173, 15 May 2014, pp. 349–496 (MiFID II) and Regulation (EU) No. 600/2014, OJ L 173, 15 May 2014, pp. 84–148 (MiFIR) stipulated that the bulk of the new legislation would become binding on the financial sector as per 3 January 2017, but this has been extended to 3 January 2018. See Directive 2016/1034/EU OJ L 175, 23 June 2016, pp. 8–11; (2) Regulation (EU) No. 2016/1033 OJ L 175, 23 June 2016, pp. 1–7. The reason for the extension lies in the complex technical infrastructure that needs to be set up for the MiFID II package to work effectively. The European Securities and Markets Authority (ESMA) has to collect data from about 300 trading venues on about 15 million financial instruments. To achieve this result, ESMA must work closely with national competent authorities and the trading venues themselves. However, the European Commission was informed by ESMA that neither competent authorities nor market participants would have the necessary systems ready by 3 January 2017. In light of these exceptional circumstances and in order to avoid legal uncertainty and potential market disruption, an extension was deemed necessary. See <http://europa.eu/rapid/press-release_IP-16-265_en.htm?locale=en>.

\textsuperscript{3} MiFID I and MiFID II are both based on the ‘Lamfalussy process’ (a four-level regulatory approach recommended by the Committee of Wise Men on the Regulation of European Securities Markets, chaired by Baron Alexandre Lamfalussy and adopted by the Stockholm European Council in March 2001 aiming at more effective securities markets regulation) as developed further by Regulation (EU) No 1095/2010 of the European Parliament and of the Council, establishing a European Supervisory Authority (European Securities and Markets Authority or ESMA): at Level 1, the European Parliament and the Council adopt a Directive in co-decision which contains framework principles and which empowers the Commission acting at Level 2 to adopt delegated acts (Article 290 The Treaty on the Functioning of the European Union C 115/47) or implementing acts (Article 291 The Treaty on the Functioning of the European Union C 115/47). In the preparation of the delegated acts the Commission will consult with experts appointed by Member States within the European Securities Committee. At the request of the Commission, ESMA can advise the Commission on the technical details to be included in Level 2 legislation. In addition, Level 1 legislation may empower ESMA to develop draft regulatory or implementing technical standards according to Articles 10 and 15 of the ESMA Regulation, which may be adopted by the Commission (subject to a right of objection by Council and Parliament in case of regulatory technical standards). At Level 3, ESMA also works on recommendations and guidelines and compares regulatory practice by way of peer review to ensure consistent implementation and application of the rules adopted at Levels 1 and 2. Finally, the Commission checks Member
States’ compliance with EU legislation and may take legal action against non-compliant Member States. See e.g. European Commission, MiFID Impact Assessment (COM(2011) 656 final), p. 356, footnote 1.


6 See Recital 27 ISD.


11 Davies, Dufour, and Scott-Quinn, (n. 5), 179–87; Ferrarini and Recine, (n. 5), 235; Köndgen and Theissen, (n. 5), 271 (specifically about Germany).


Investing by participating in an investment fund is a form of collective investment. The invested capital is then raised by a number of parties, whose capital is then collectively invested by the investment manager. In other words, profits and losses are apportioned among the participants in proportion to the amount of their participation. On this subject, see e.g. Danny Busch and Lodewijk van Setten, ‘The Alternative Investment Fund Managers Directive’ in Lodewijk van Setten and Danny Busch (eds) Alternative Investment Funds in Europe: Law and Practice (Oxford: OUP, 2014), pp. 1–122.

See Article 4(1) and (2) MiFID I in conjunction with Annex I, Sections A and C; Article 4(1) and (2) MiFID II in conjunction with Annex I, Sections A and C.

In practice this type of investment service is often termed ‘execution only’. This is however a confusing term, as in practice ‘execution only’ is also used to refer to the investment activity of dealing on own account (see main text).

See Annex I, Section A of both MiFID I and MiFID II. Most investment services and activities are defined in more detail.

See Annex I, Section A(9) MiFID II.

Title II MiFID I and MiFID II sets out the rules for investment firms, and Title III MiFID I and MiFID II the rules for regulated markets.

See Article 4(1)(15) in conjunction with Annex I, Section C MiFID I; Article 4(1)(15) in conjunction with Annex I, Section C MiFID II. See on the broadening of the scope of ‘financial instrument’ under MiFID II: § II sub (1), below.

See Article 5(1) MiFID I and Article 5(1) MiFID II.

See Article 6(3), (31), and (32) MiFID I and Article 6(3), (34), and (35) MiFID II.

Articles 9–13 MiFID I and Articles 9–16 MiFID II.

Article 16 MiFID I and Article 21 MiFID II.

Article 18 ff MiFID I and Article 23 ff MiFID II.

See Article 1(2) MiFID I and Article 1(3) and (4) MiFID II.

See also n. 17 above.


EU CoJ 30 May 2013, no. C-604/11, AA (2013) 663, with note by Busch; JOR 2013/274, with note by Busch (Genil 48 SL and Other v Bankinter SA and Others).


On the subject of better regulation, see for example the European Parliament, Briefing of September 2014, Hearings of European Commissioner-designate—Frans Timmermans, p. 2: ‘The aim of Better Regulation is to promote the simplification of EU law, reducing the administrative burden, especially for business, and to ensure respect for the principles of subsidiarity and proportionality.’ (Available at: <http://www.europarl.europa.eu/EPRS/Commissioner_hearings/EPRS-Briefing-538921-Better-Regulation-FINAL.pdf>.)
