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1 Overview and Glossary

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(p. 1) 1 Overview and Glossary

A. Subject Matter, Objective, and Organization of This Book

1.01 This book is about investment in financial assets, that is, stocks, bonds, derivatives, structured products, etc. Investment, broadly speaking, concerns the conversion of investor savings into funding for the real economy in exchange for an investment return. It involves the continuous selection and deselection of the appropriate risky financial asset in the context of an investment horizon and investment objective. What is appropriate is determined by reference to the chosen investment risk parameters and estimations of the risk and return properties of the available financial assets, individually and in a portfolio context.

1.02 The financial system facilitates the investment selection, capital transfer, and investment risk management process.[1] It is accessed through the financial services sector, that is, the banks and investment firms that perform trading, payment and settlement, custody, portfolio management, and financial advisory services. (p. 2) The sector has, for now—the FinTech sector may yet disrupt fundamentally—a monopoly on the business of creating, offering, trading, transferring, and administrating financial assets. Investors in financial assets, therefore, have no choice but to transact through or with these professional firms.

1.03 This book seeks to analyse the legal and regulatory principles that operate on the series of steps and actions that need to be taken through banks and investment firms to invest an investor's capital in, or disinvest the same from, financial assets. These steps may be referred to as the 'investment cycle'. Each step necessarily involves the engagement of a financial services firm. Consequently, investment in financial assets exposes the investor not only to market risk (the value of an investment may go up or down), but also to the risk of loss due to professional failure of a firm, known as 'conduct risk', or failure of a firm to return the investor's property or otherwise to perform its payment or delivery obligations, known as ‘credit risk’. The central theme is the level of protection—in terms of risk mitigation—against conduct and default risks that the operative legal and regulatory principles offer at the various stages of the investment cycle.

1.04 The activities of the financial services sector are governed by a body of substantive law and regulatory rules that is commonly referred to as ‘financial law’. It is often suggested that the substantive component of financial law is elusive given the intemperate change and innovation of the financial services sector and its product offerings. Though paced evolution is a key feature of the financial sector, the view that financial law is elusive possibly fails to separate the sector’s economic vibrancy, financial engineering acumen, and far-reaching societal impact from the legal structure of the transactions that underpin its activities. Offerings of equity and debt instruments, as well as forward, option, swap, repo, and securities lending transactions, are all made under and governed by often well-established general principles of company law and the law of agency, contract, property, and trusts. Take as an example so-called collateralized debt obligations (CDOs), which were instrumental in transferring credit exposure to non-performing mortgages during the 2000s, ultimately causing havoc in the real economy in 2007 and 2008. The pay-out structure and conditions of the CDOs were complex and lacked intelligible transparency, which made it difficult to assess the investment risk. In the hands of their investors, however, CDOs were straight forward debt instruments, ‘notes’, issued by special purpose vehicles, and there was no uncertainty as to the operative principles of financial law. In fact, as far as complex transactions in financial assets were concerned, such as structured notes, swaps, and repos, financial law worked well when it was tested under systemic stress in 2008, not in the least due to the excellence of the standard market documentation under which derivatives and securities finance transactions are commonly executed and collateralized.[2]

(p. 3) **1.05** To the extent that there were meaningful delays due to a lack of substantive clarity of financial law in 2008 these were caused by questions around proprietary interests in financial assets and money. It concerned the way in which client assets and money are held by investment firms, in particular by prime brokers. These legal uncertainties came about because the financial system’s ‘plumbing’ or ‘infrastructure’ models changed over time, but the substantive law did not develop in tandem. However, it cannot be said that the financial law issues relating to the plumbing of the financial system are either new or the result of fast-paced innovation. The legal uncertainty caused by changing infrastructure models in cross-border markets has been well understood since at least the 1990s. Following a multi-year review, the Giovannini Report observed in 2001:[3]

> **Barrier 13: The absence of an EU-wide framework for the treatment of interests in securities.**
>
> This barrier (and barrier 15) arises directly from the fact that in modern markets the law fails to keep pace with developments in market practice. In essence, modern practice co-locates securities with the systems through which they are settled. The law has yet to catch up. Furthermore, EU Member States have different concepts of property and ownership (often disguised by the use of expressions such as ‘proprietary rights’ and ‘rights in rem’ as if they had a meaning common to all EU legal systems.) The absence of an EU-wide framework for the treatment of interests in securities (including procedures for the creation, perfection and enforcement of security) has been identified as the most important source of legal risk in cross-border transactions.

The English courts have had ample opportunity to consider some of the complexity caused by account-based holding of fungible pools of securities and money in a series of decisions made in respect of the business of the insolvent Lehman Brothers International (Europe) (LBIE), the UK subsidiary of Lehman Brothers Holdings Inc, an insolvent US financial holding company. These decisions have made significant strides in clarifying how English law operates to impress equitable co-ownership on the fungible pools of money and financial assets held by investment firms for the benefit of their clients.

(p. 4) **1.06** This book is structured around the roles of investment firms and banks during the investment cycle as financial adviser, investment manager, broker, dealer, and custodian in relation to the selection of investments, the execution of the corresponding trade, the settlement of that trade, and the holding and administration of the acquired financial asset:

(a) *Chapter 1 (Overview and Glossary)* sets the stage by describing the core components of the investment cycle, highlighting the professional character of the services and activities of investment firms, analysing the operation of agency principles on the performance of contracts for investment services, and identifying conduct and credit risks as the key risks the investor faces during the investment cycle. The chapter also offers a glossary of terms, hopefully, to support the clarity and consistency of the analysis.

(b) *Chapter 2 (Financial Assets and Investment Risk)* addresses the economic concept of financial assets and the notion of investment risk. The present and expected future value of the financial asset is intrinsic to every aspect of the investment process and the professional services provided in connection with it. Chapter 2 seeks to identify the various categories of financial assets and their risk and return properties. It informs the skill, know-how, and care that may be expected of the professional who provides investment advice or discretionary portfolio management. It also informs the assessment of the quantum of loss in case of error, omission, or insolvency.

(c) *Chapter 3 (Safeguarding Financial Assets)* analyses the legal properties of financial assets and money, and the way interests in financial assets and money are acquired through credits to securities and cash accounts or booking of positions in clearing accounts, or the way financial assets and money are used as collateral. The analysis focuses on the investor's proprietary protections and potential risk of loss of financial assets in the event of insolvency of an account provider, be it a bank, a custodian, a broker, or a clearing member.

(d) *Chapter 4 (Legal and Regulatory Duties to Protect the Client's Interest)* outlines key legal and regulatory concepts that operate to control the conduct of investment firms that provide financial advisory, portfolio management, brokerage, or dealer services, including the regulatory duty to act fairly and in the best interest of the client, the duty to provide information or to advise, and duties to manage conflicts.

(e) *Chapter 5 (Client Agreements and Compensatory Damages)* outlines the standard of skill and care and other duties and responsibilities, including in connection with the appointment of subcontractors (outsourcing), that will normally be implied in the client agreement, which is an agreement for the supply of professional services. The Chapter also analyses duties to compensate the investor for losses caused by breach of duty by an investment firm.

(f) *Chapter 6 (Trading and Settlement)* describes the common organizational and structural aspects of trading venues, and analyses the responsibility of investment (p. 5) firms that offer trading services. It also looks at the post-trade environment, that is, the operation of settlement systems, with a focus on protective features that mitigate settlement finality risks, meaning, the risk that a settlement may not become final due to adverse claims or insolvency.

(g) *Chapter 7 (Investment and Wealth Management)* analyses the responsibilities of investment firms that offer investment and wealth management services.

B. The Investment Cycle and the Investment Professionals

1. The stages of the investment cycle

1.07 The process of investment in financial assets is best described as a cycle that can be divided into four operational stages: the investment decision, the execution of that decision, the settlement of the resulting transaction, and the administration of the acquired investment. At each stage, the investor will rely in some manner on the special skills and know-how of an intervening investment firm.

1.08 The first operational stage of the investment cycle concerns the investment decision. Investment concerns the transfer of capital in return for claims on future payments. Risk and return go hand-in-hand. When done appropriately, higher risk means a probability of higher returns, but the flip-side of that coin is the probability of loss. Investment decisions are driven by the investor's purpose and situation, in particular, the investor's investment horizon, return expectations, and risk appetite. The investor needs to consider the investment in the context of available alternatives and information. The investor may arrive at the decision independently or with the assistance of professional investment advice, that is, a professional recommendation from an investment specialist based on a consideration of the situation, investment purpose, and the risk appetite of the investor.

1.09 The investor may have outsourced the investment selection to a specialist investment manager by way of a mandate, which gives the manager control over a certain portfolio of financial assets of the investor. The investment manager, rather than the investor, will make the investment decision within the parameters of the mandate, that is, the investment objective, the universe of eligible investments, and any investment restrictions or risk parameters. The mandate parameters may be informed by an investment strategy that is developed and maintained by the investment manager, and which the investor has selected. In the event that the investor appoints a discretionary investment manager, the investor makes an investment decision at the time that the investor selects an investment strategy on offer from that investment manager. The investor may have obtained investment advice in connection with the selection of the investment strategy, and this advice may have been offered by the investment manager prior to signing the mandate. Equally, if the mandate is bespoke, the investment (p. 6) manager may be giving investment advice to the investor in connection with the design of the mandate.

1.10 The second stage concerns the execution of the investment decision. Depending on how the financial asset in question is traded, the investor will need to instruct a broker to acquire the financial asset for the account of the investor on an organized market, or the investor will enter into a transaction with a dealer. If the investor has appointed a discretionary investment manager, the investment manager is responsible for execution and, therefore, the instruction to the broker or the transaction with the dealer will be made by the investment manager on behalf of the investor. If the financial asset is traded on an organized market, the broker will need to act through that market and the execution of the transaction for the investor is then dependent on the functionalities of the market in question, including its trading, clearing, and central counterparty infrastructure.

1.11 The third stage concerns settlement of the transaction made with the dealer or made by the broker. Values need to be exchanged between the investor and the dealer or the broker, and the broker and its market counterparty. The investor's custodian plays a central role in that exchange process. The investor will need to have opened cash and securities accounts at the custodian. The custodian, in turn, will need to have access to the various payment and securities settlement systems that permit transfer of the relevant values required to settle the investor's transaction.

1.12 The fourth stage concerns storage, the holding and safe keeping, and the administration of financial assets. Administration includes the exercise of rights attaching to securities, commonly referred to as 'corporate actions', and other rights, such as option rights, the collection of income, and the posting of collateral. Financial assets that are equity and debt securities will usually be held by way of deposit by the issuer with a central securities depositary (CSD), who in turn will establish the deposited securities in book-entry form on participant accounts. The investor will acquire rights in respect of the deposited securities via its custodian, who will exercise the investor's rights against the CSD as a direct participant, or via a sub-custodian who is a participant in the CSD. Financial assets in contractual form such as forward, future, and option contracts, are typically held through a central counterparty (CCP) by way of a riskless principal arrangement in which the CCP acts as intermediary to buyers and sellers. The investor exercises rights through intermediation of a clearing member who is a participant in the CCP.

1.13 Having arrived at the fourth stage, the investor will need to consider whether and when to dispose of an investment. The disposal decision may be driven idiosyncratically by market events, but in the absence of that, the deselection will normally be part of the selection process at the first stage because acquisition decisions usually are made in the context of the portfolio of financial assets held by the investor to determine whether the proposed acquisition will maintain the (p. 7) desired portfolio construction and if not, whether and which existing financial assets need to be sold. Equally, an acquisition may need to be financed by the sale of an existing investment and the investor will have to consider which investment to select. Depending on the function of an investment firm, its role may be to monitor each investment held by the investor and determine, or to assist the investor in determining, whether an investment may need to be selected for disposition.

1.14 In summary, during the investment cycle, the following professional services will typically be provided to the investor:

(a) An investment services firm may have assumed responsibility as investment adviser to advise on, or, as investment manager, to exercise discretionary responsibility for the selection of a financial asset or portfolio of financial assets for investment or disinvestment.

(b) An investment services firm will be instructed as broker or as dealer, either by the investor or by an investment manager acting on behalf of the investor, to execute one or more trades for the account of, or with, the investor in relation to the selected financial asset or portfolio of assets.

(c) If the financial asset in question is traded on an organized market, the acquisition or disposition agreement will have to be made via that market's trading functionalities. The trading venue may include trade clearing and CCP functions.

(d) A bank/custodian will facilitate the settlement of the trade and arrange for the transfer or receipt of the financial asset in question and the payment or collection of money in connection with the transaction.

(e) If the financial asset is immobilized or immaterialized through a CSD and transferred by way of book-entry, the intermediary chain that runs from the custodian through any sub-custodians to the CSD, who holds the ultimate financial asset, will provide services at every link in the chain.

2. Investment services are professional services

1.15 Investment in financial assets concerns the financial well-being of the investor. Financial well-being is of central importance to individuals and institutions alike, and an investor's interest in the investment of capital in financial assets may therefore be described as a 'fundamental interest'. Investment services firms are in the business of offering, and hold out as possessing, specialist knowledge, skill, and care to assist in the pursuit of the investor's financial interest. The combination of a fundamental interest and the reliance on the application—by way of business—of specialist knowledge, skill, and care in the service of that fundamental interest characterizes investment services as a professional business. The defining property of a professional business is an expectation of high standards of competence and integrity. It means not only that the investment firm is expected to meet the (p. 8) requisite specialist standards of knowledge, skill, and care, but also that the investment firm is expected to put the interest of the investor at the heart of the investment service and to postpone its own interests.

1.16 In common with professional services industries generally, the investment services industry features high knowledge intensity, professionalization, and low capital intensity:[4]

(a) *High knowledge intensity* means that the offering of its investment services by a firm depends on intellectually skilled individuals at every level of that firm, from senior management to investment and trading professionals, operations and IT experts, and professional support functions such as legal, tax, finance, and human resources.

Intellectually skilled individuals tend to prefer autonomy and informal organizational processes. Specialist investment services skills, particularly investment and trading skills, are scarce and transferable across firms. Consequently, the management structures of investment services firms feature two aspects that are typical for high knowledge intensity industries: alternative compensation arrangements, and autonomy and informality of its organizational structure.

(b) *Professionalization* means that the offering of investment services is, or ought to be, driven by high integrity standards. These are standards of loyalty, good faith, disclosure, and professional values, the latter being a system of principles and values that guide conduct and are generally accepted by the industry. The loyalty is to be directed at the client's interest and imposes a requirement to postpone other interests. The norm includes a 'no conflicts' rule, including no undisclosed ancillary profits and a duty of confidentiality. It expects the intermediating investment firm to be loyal to the interest of the client it is serving in any given circumstances, and always to postpone its own interest for the benefit of the interest of that client at that time.

The operation of the duties of loyalty, good faith, and disclosure distinguish the professional service from other commercial activities, which, rooted in the notion of *caveat emptor*, permit an arm's length approach within the boundaries of vitiating factors. A tension rises, therefore, if an investment services firm operates a service model that is based on dealing as principal with its clients. A broker by nature acts as agent *ab initio* and must deal under the umbrella of the professional norm if it accepts an investor's order, even if it ultimately fulfils the order as principal. A dealer, on the other hand, accepts orders as principal and will seek to operate in the realm of *caveat* *emptor*, (p. 9) which raises the question to what extent that realm is restricted by duties of loyalty and good faith.

(c) *Low capital intensity* means that the offering of investment services is not contingent on real assets, including, except for information technology, intangibles such as patents and copyrights. Low capital intensity reduces the need for an investment firm to ensure that its governance model aims to protect public equity stakeholders. It also implies that the distribution on any insolvency liquidation is usually low; the firm's value derives from a going concern of professionals.

1.17 Firms that are in the business of providing the investment services specified in Appendix A[5] to MiFID II,[6] 'investment firms', must be authorized and supervised in accordance with the framework set out in MiFID II and MiFIR.[7] Article 24(1) of MiFID II codifies the expectation of competence and integrity that is implied in the provision of a professional service: investment firms must 'act honestly, fairly, and professionally in accordance with the best interest of the client' when providing an investment service.

C. The Inherent Risks of the Investment Cycle

1. Conduct risk

1.18 Conduct risk, as a concept, is nebulous. In legal terms, as between the investor and the financial services firm, it can be defined as the risk of loss due to professional failure of the investment firm, which, aside from fraud, may be divided into (1) failures of effort, that is, a failure to use the requisite skill, know-how, or care in the pursuit of the interest of the investor; and (2) failures of integrity, that is, a failure to adhere to standards of disclosure or requirements for informed consent, or to professional values. Failures of integrity may manifest through exploitation of asymmetric information or the pursuit of a self or third-party interest.

(p. 10) **1.19** The Financial Conduct Authority (FCA) has introduced a much broader concept of 'conduct risk' in its supervisory toolkit, without seeking to define it generally, expecting individual firms to do so in the context of their conduct risk management programmes. A statement on the FCA's website in April 2014 observes that definitions formulated by regulated firms 'typically refer to client outcomes and some include factors such as sustainability of their business and market integrity. Other elements include the danger of actions or behaviours, or the conduct of business, that may: harm clients; cause the firm reputational damage; risk undermining the integrity of the financial markets'. In other words, in its earlier iterations, the supervisory notion of conduct risk was scoped, loosely, by reference to behaviour that leads to a poor outcome for the firm, markets, or customers, that is, the regulatory concept of conduct risk operates beyond the relationship between a firm and a client.

1.20 The FCA's feedback statement '5 Conduct Questions', Industry Feedback for 2017 notes that:[8]

> The FCA provides substantial information in its Mission Statement, Business Plans and through discussion of its statutory objectives all of which serve as a clear foundation for addressing conduct risk. However, the FCA does not provide an explicit definition of conduct risk as part of the 5 Conduct Questions programme. This is because it is essential for firms to work through this task themselves as a preparatory step for designing, prioritising and monitoring change management initiatives. By 2017 nearly all the firms we reviewed had working definitions, but a few still lacked an agreed definition. Some earlier definitions failed to address the importance of outcomes involving staff and other key stakeholders and this has been remedied. More advanced firms are on second or third iterations, having

added risks to market integrity or effective competition. As well as refining their definitions, a few firms have taken the formal step of ensuring it is adopted globally

1.21 The five questions are:

(a) What proactive steps do you take as a firm to identify the conduct risks inherent within your business?

(b) How do you encourage the individuals who work in front, middle, back office, control and support functions to feel and be responsible for managing the conduct of their business?

(c) What support (broadly defined) does the firm put in place to enable those who work for it to improve the conduct of their business or function?

(d) How does the Board and ExCo (or appropriate senior management) gain oversight of the conduct of business within their organization and equally importantly, how does the Board or ExCo consider the conduct implications of the strategic decisions that they make?

(p. 11) (e) Has the firm assessed whether there are any other activities that it undertakes that could undermine strategies put in place to improve conduct?

1.22 The FCA further introduced the notion of 'culture' as the prime determinant of conduct (or behaviour) in a 2016 statement entitled 'Culture in Banking':

> A focus on the culture in financial services firms is a priority for the FCA. Culture drives individual behaviours which in turn affect day-to-day practices in firms and their interaction with customers and other market participants. Culture is therefore both a key driver, and potential mitigant, of conduct risk. The experience of the past demonstrates that a poor culture can lead to poor outcomes for consumers and markets. This is widely recognised and there has been a considerable amount of work done across the industry to increase the focus on culture.

Culture, as a set of value and experienced based norms, may probably best be described as a determinant of conduct, that is, the way a person behaves.[9] The Group of Thirty (G30) published a report in 2015 that defines culture in those terms:[10]

> We define culture as the mechanism that delivers the values and behaviors that shape conduct and contribute to creating trust in banks and a positive reputation for banks among key stakeholders, both internal and external.

Values, as an ingredient of culture, shape conduct or, to use an alternative word for the same concept, behaviour.[11]

1.23 The Prudential Regulation Authority (PRA) places accountability and responsibility for the (risk) culture firmly in the hands of the management body of a firm:[12]

> The board should articulate and maintain a culture of risk awareness and ethical behaviour[13] for the entire organisation to follow in pursuit of its business goals. The PRA expects the culture to be embedded with the use of appropriate incentives, including but not limited to remuneration, to encourage, and where necessary require, the behaviours the board wishes to see, and for this to be actively overseen (p. 12) by the board. The non-executives have a key role to play in holding management to account for embedding and maintaining this culture.

1.24 The notion that culture is a matter for direction and control by the governing body is widely accepted and returns in most regulatory reports and guidelines. The PRA has enshrined it into its rule book by requiring firms to appoint senior managers with responsibility for 'overseeing the adoption of the firm's culture in the day-to-day management of the firm' and for 'leading the development of the firm's culture by the governing body as a whole'.[14] The FCA observes in its Consultation Paper on the introduction of the Senior Manager & Certification Regime for investment management and other non-bank firms in July 2017:

> The SM&CR is a key part of our priority of Culture & Governance at firms set out in our 2017/18 Business Plan. Culture is the product of a number of different drivers within firms and is shaped by many influences that drive the behaviour of everyone in an organisation. The 'tone from the top', the effectiveness of management and governance and incentive structures all contribute to the overall culture of a firm.[15]

1.25 The emphasis on senior management's responsibility for culture is presumably based on the assumption that culture is formed through learning, and learning can occur through leadership.[16] This assumption possibly does not do justice to the complexity of organizational reality. If, as Schein proposes, culture is the result of an evolutionary process that shapes a shared system of believes, values, and behavioural norms over a significant period, of which senior management itself is a product, a management team can only seek to manage a given and often complex set of circumstances. Thoughtful governance design can assist leadership with evolving organizational culture by embedding certain values in the organizational structure, particularly in its control framework. That would justify requiring the management body to have a good grasp of the corporate culture and to seek to address perceived defects. It may be less justifiable to hold the management body responsible for the status quo of that culture.

1.26 Accordingly, the regulatory concept of 'conduct risk' has evolved as a governance tool. It singles a specific set of objectives of a firm's business and operating models out for separate and distinct risk management. In regulatory terms, conduct risk management is part of a firm's internal control framework.[17] This book (p. 13) analyses the relationships between an investor and a financial services firm, and an investor and a financial asset. Conduct risk, therefore, is used in that narrower bilateral context as the risk of loss due to professional failure of the investment firm. The questions asked in this book concern the legal and regulatory standards of conduct that apply to an investment firm in the performance of the investment service.

2. Product governance is a special form of conduct risk management

1.27 The objective of the investor in financial assets is to take investment risk. The role of the investment firms is to assist the investor in taking the steps necessary to bring the intended investment exposure about. Those steps may concern advising on, offering, or assisting with the acquisition or disposition of the financial asset, and may include the creation of the target financial asset by the investment firm.

1.28 Traditionally, the regulatory focus has been on the quality of the investment service, that is, a firm's conduct of business.. Conduct of business regulation has been operative under the Investment Services Directive (ISD) and its successors, MiFID I and MiFID II, since the mid-1990s.[18] The properties of the financial asset that is the subject of an investment firm's recommendation, offering, or acquisition efforts have had less direct attention. However, this is changing. Increasingly, financial assets are referred to as 'investment products'.[19]. The use of the product terminology denotes an activity chain: 'products' need to be 'manufactured', 'distributed', and 'serviced'.[20] The increased prominence of the product terminology in the regulatory description of the financial asset and the activities of the intermediating investment firm accompanied a shift in regulatory focus after the manifestation of systematic risks in 2007 and 2008 to ‘product regulation’. Product regulation concerns the regulator’s ability to prescribe or circumscribe the properties of a financial product. Prior to that shift (p. 14) in focus, product regulation of financial assets was mostly limited to regulated collective investment schemes.[21]

1.29 Distinguishing between the responsibilities of the investment firm for the quality of the investment service and the responsibilities for the quality of the investment product is not always straight forward. It is, of course, possible that a financial asset is, in product terms, ‘defective’ for example because it is intrinsically incapable of achieving the purported investment objective. More often, however, the financial asset may be unsuitable for the investor in question, but not for others, so that the issue centres on whether it was right and appropriate for the investor to acquire the financial asset and consequently, the question concerns the quality of the investment service.[22]

1.30 Reflecting preceding regulatory developments in the United Kingdom,[23] MiFID II introduced a broad sweep ‘product governance’ regime as part of its organizational requirements for investment firms,[24] and elaborated on the regime in Chapter III (Product Governance Requirements) of Delegated Directive (EU) 2017/593.[25] Recital 15 of that Directive provides the rationale (emphasis added):

> In order *to avoid and reduce from an early stage potential risks of failure to comply with investor protection rules*, investment firms manufacturing and distributing financial instruments should comply with product governance requirements. For the purpose of product governance requirements, investment firms that create, develop, issue and/or design financial instruments, including when advising corporate issuers on the launch of new financial instruments, should be considered as *manufacturers* while investment firms that offer or sell financial instruments and services to clients should be considered *distributors*.

1.31 Chapter III (Product Governance Requirements) of the Delegated Directive (EU) 2017/593 contains the product governance regime for ‘manufacturers’ and ‘distributers’ of investment products. The cornerstone requirements for manufacturers can be summarized as follows:

(a) Article 9(2) and (3): the manufacturer must have the interest of the end investor in mind as part of the production process and manage inherent conflicts of the product, including those arising from remuneration structures. Without limiting the general scope, the provisions of Article 9(2) and (3) specifically instruct the manufacturer to ensure that the product’s design ‘does (p. 15) not adversely affect end clients or does not lead to problems with market integrity’ in particular ‘by enabling the firm’ to reduce or hedge its own exposure to the financial asset or assets that comprise the investment product. [26]

(b) Article 9(4): the manufacturer must consider whether the investment product ‘may represent a threat to the orderly functioning or to the stability of the financial market before deciding to proceed with the launch of the product’.

(c) Article 9(9) to (11): the manufacturer must identify the ‘target market’ for each product based on a suitability analysis and ensure that the investment product’s risk/return profile continues to meet the needs, characteristics, and objectives identified by the distributer in relation to the target market, subject the investment product to adverse scenario analyses (stress testing).

(d) Article 9(12): the manufacturer must ensure that the fees and costs charged as part of the product are appropriate in view of the identified needs, characteristics, and objectives of the target market.

1.32 The cornerstone requirements of Delegated Directive (EU) 2017/593 for *distributers* can be summarized as follows:

(a) Article 10(2): the distributer must independently, but based on information obtained from the manufacturer, identify the target market and ensure that 'the intended distribution strategy' is consistent with the properties of that target market, in particular so that their 'clients' interests are not compromised as a result of commercial or funding pressures'.

(b) Article 10(5): distributers must regularly review the range of investment products offered or recommended to clients continues to meet the identified needs, characteristics, and objectives of the target market, in particular 'taking into account any event that could materially affect the potential risk to the identified target market'.

(p. 16) **1.33** The MiFID II product governance regime has introduced *ex post* intervention powers, as opposed to *ex ante* authorization requirements.[27] Failure to comply with the product governance provisions of Article 16(3) of MiFID II and its implementation legislation in Articles 9 and 10 of Delegated Directive (EU) 2017/593 could result in product intervention by a competent regulator who may 'suspend the marketing or sale of financial instruments or structured deposits where the investment firm has not developed or applied an effective product approval process or otherwise failed to comply with Article 16(3) of [MiFID II].'[28]

1.34 In addition, subject to the restrictions of Article 40(3) of MiFIR, the European Securities and Markets Authority (ESMA) may exercise 'temporary' intervention powers if the conditions of Article 40(2) of MiFIR have been met, which require the existence of a 'significant investor protection concern or a threat to the orderly functioning and integrity of the financial markets or commodity markets or to the stability of the whole or part of the financial system' that are not otherwise addressed by national competent regulators or national measures.[29]

1.35 As Recital 15 observes, 'from an early stage' (in the investment product's life cycle) the manufacturer must consider the integrity of the design of the product in the context of its intended use by the (theoretical) target investor. Inherent conflicts must be identified and managed, and cost and charges must be considered in the context of the product's risk and return properties. Throughout the life cycle, the investment firm must satisfy itself that the investment product continues to meet the requisite design parameters. In other words, the product governance rules impose structural limitations on the investment firm that are akin to prudential regulation of the investment firm.[30] Product governance requirements impose organizational conduct controls that channel (target market) and shape (design parameters) the investment service. Product governance supplements the bilateral controls that flow from the legal and regulatory principles that operate on the provision of that investment service to an investor. It adds a substantive layer to the (p. 17) investor protection rules by requiring that the design of the investment product is inherently balanced, both in terms of suitability in view of the target investor as in terms of its costs and charges structure relative to its risk and return properties.[31] Product governance, therefore, reduces the chance that the investor acquires an unsuitable or inappropriate investment product, particularly if the scope of the investment service is limited.[32]

1.36 According to the reference in Recital 15 to 'investor protection rules' together with the references in Articles 9 and 10 to conflicts, remuneration, and market integrity, the product governance provisions of must be read in conjunction with the provisions in Chapter II (Operating conditions for investment firms) of Title II of MiFID II regarding investment firms' responsibility for the management of conflicts of interest,[33] remuneration structures,[34] and suitability and appropriateness testing.[35] The addition of prudentially oriented product governance rules to the conduct oriented investor protection rules subjects the manufacturing investment firm to a matrix of investor protection responsibilities throughout the investment cycle.[36] Although it is early days in empirical terms, it is reasonable to conclude that the product governance rules mitigate conduct risk for the investor as it reduces the scope for an investment firm to rely on disclosure and *caveat emptor*. It should also reduce the inherent risk of 'poor choices' due to limitations on the investor's skill and know-how because compliance with the product governance rules harnesses the professional skills and know-how of the manufacturing investment firm.[37]

3. Credit and systemic risks

1.37 When a client instructs an investment firm to advise on the acquisition or disposal of an asset, or to acquire, hold, or dispose of that asset for the account of that client, the client is exposed to the risk of loss or deterioration if the investment (p. 18) firm fails to make a payment or transfer a financial asset or assets when due, because of refusal, operational failure, third party intervention, or insolvency, which could result in loss or reduced value of the financial asset or claim because the client experiences delayed return of a financial asset or a payment due, or needs to share in a liquidation distribution as a general creditor of the investment firm. Various legal and regulatory structures operate to mitigate potential losses that could result from a firm's failure to perform it payment or delivery obligations.[38]

1.38 The investor's exposure is not limited to the idiosyncratic credit risks associated with a certain investment firm. The investor is also exposed to systemic risk inherent in the financial system. Systemic risk has been defined broadly in a 2009 Report prepared for the G20 Finance Ministers and Central Bank Governors as the risk of:[39]

> [T]he disruption to the flow of financial services that is caused by (i) an impairment of all or parts of the financial system; and (ii) has the potential to have serious negative consequences for the real economy.

1.39 The Report observes that:

> Individual financial institutions can manage their own risk/return trade-off but not necessarily the implications of its risk taking for the operation of the financial system as a whole. An impairment or disruption to the flow of financial services would include situations where certain financial services are temporarily unavailable, as well as situations where the cost of obtaining the financial services is sharply increased. It would include disruptions due to shocks originating outside the financial system that impact on it, as well as shocks originating from within the financial system. A systemic event should be contrasted with more general wealth effects that may have severe macroeconomic consequences but are not associated with the impairment of the financial system. The definition requires significant spillovers to the real economy, without which an impairment of financial services would not be considered systemic. The real economy impact could be either through

an effect on supply or through an effect on demand for other goods and services, and could materialize over an extended period of time.

1.40 Systemic risk, broadly, is the risk that a shock, such as the collapse of a market or the failure of an institution, triggers through panic or otherwise the failure of other markets or institutions, or a chain of significant losses to financial institutions, resulting in a material disruption of increase in the cost of capital or a material decrease of capital available to the real economy.[40] Systemic risk (p. 19) materializes, as the G20 Report describes, when cumulative risk-taking in the financial system results in a collapse of the offering of capital to the real economy. This book focuses on the individual relationships between an investor and the firms who serve the investor throughout the investment cycle. The controls that are available to governments, central banks, and regulators to mitigate the inherent systemic risk of the financial system that affect all investors are not specifically examined.

1.41 The failure of Lehman Brothers in September of 2008, a large, globally connected financial institution, demonstrated the risk to financial stability of the 'too big to fail' challenge. The largest financial institutions are interconnected with others through large volumes of financial transactions of various types. The Lehman Brothers' failure highlighted the risk of close-out netting terminations provisions in derivative and securities financing transactions. The abrupt terminations of large numbers of contracts on the occurrence of Lehmans' insolvency were a key driver of the destabilization that resulted from its failure.[41] The problem can be that 'out-of-the-money counterparties, which owe the failed institution money, will typically choose not to terminate their contracts and instead suspend payment, reducing the liquidity available to the failed institution.[42] This can, and did, severely interrupt the disorderly resolution of Lehman.[43]

1.42 Governments around the world, particularly the G20, have shown unprecedented cooperation in addressing the problem in, essentially, two ways: reduce the probability that a systemically important financial institution will fail, and reduce the potential for damage, should such a failure occur nevertheless. The first type of measure concerns capital requirements and activity restrictions. The second type of measure seeks to ensure that the resolution of a failed financial institution—such as insolvency or special resolution or administration procedures—would be more orderly than the Lehman Brothers resolution has been, which helps to (p. 20) mitigate destabilizing effects on the rest of the financial system.[44] In addition, governments have sought to improve transparency of derivatives and securities financing transactions and improve the holding and collateralization infrastructure through mandatory clearing obligations.[45]

1.43 *Systemic* risk should be distinguished from downturns that are caused by market swings, which is more appropriately described as *systematic* risk, meaning investment risk that cannot be diversified away. Systematic risk-taking is an intrinsic part of investment risk.[46] Depending on the function of an investment firm, its role may be to determine, or to assist the investor in determining, whether systematic risk in the circumstances is an appropriate or suitable risk for the investor to take. The legal and regulatory principles that apply to the scope and performance of the specific role of an investment firm are very much part of the analysis of the inherent intermediary risks and the protections available to investors.

D. Investment Firms as Agents of the Investor

1. The creation and use of agency authority

1.44 Certain investment services, such as portfolio management and brokerage services, require the investment firm to implement investment decisions on behalf and for the account of investors and will therefore need to be able to make contracts, give instructions, and do other things as agent for, and on behalf of, the investor. Agency authority is the power that the law assigns to a person, the agent, by reason of the consensual legal relationship between the agent and another person, the principal, to affect the principal's legal relations with third parties, that is, (p. 21) with persons other than the principal and the agent, including relations with such parties with property. Parties create a consensual legal relationship of principal and agent between them if one, the principal, manifests assent that the other, the agent, should act on its behalf with a view to effecting its relations with third parties, and the agent similarly manifests assent so to act or so acts pursuant to that manifestation.[47] The usual manner of creating the agency relationship is to embed it in the client agreement between the investor and the investment firm. The client agreement reflects the investor's assent that the investment firm should act on its behalf, and similarly, the investment firm's assent so to act.

1.45 The agency relationship creates legal power in the investment firm to bring about contracts between the investor and a third party, notwithstanding that the investment firm, and not the investor, is acting. Accordingly, in the absence of other indications, when the investment firm makes a contract with a third party as agent pursuant to the client agreement, purporting to act solely on behalf of the investor as principal, whether the investor is identified or unidentified, that contract is the contract of the investor, and not of the investment firm.[48] That is the very essence of the operation of the principles of the law of agency. One party—the agent—transacts, but the law attributes this transaction to another party—the principal—as if the principal, and not the agent, had acted personally.

1.46 There is no reason why persons acting as agent when making a contract for their principal cannot by that contract provide that they themselves shall have rights and liabilities on that contract, either concurrently with, or to the exclusion of, the principal.[49] The agent is still subject to the duties that an agent has to its principal, including the applicable fiduciary duties.[50] This is important in the context of on-exchange broker intermediated transactions. The rules of the trading venue will insist on agents being a party to the transactions executed pursuant to the agency mandate and on exclusion of the principal's right to sue on the contract.[51]

1.47 Where the investment firm gives the third party to understand that it acts as agent, without identifying the principal, the agency is disclosed, but the principal unidentified. In circumstances of unidentified principles, a question may arise (p. 22) whether the agent, despite disclosing the agency, assumed personal liability on the contract concurrently with the unidentified principal or principals. The answer turns on interpretation of the relationship between the agent and the third party.[52] For instance, 'sell-side' market participants, that is, brokers and dealers, will know, or, as reasonable persons, ought to understand, that 'buy-side' market participants, that is, investment managers, intend to act as agents for investors only, and do not intend to become personally liable on the contracts they make for those investors.

1.48 Portfolio management firms very often will not identify the investor until the transaction is executed, and even then, only by reference to the investor's securities and cash accounts for settlement purposes, the details of which will rarely suffice to reveal the identity of the investor. Sometimes, the investment mandate even requires that the portfolio management firm keeps the identity of the investor confidential.[53] Notwithstanding the lack of identification of the principal, the sell-side firm will have neither the intention nor the regulatory or financial capacity to assume liability in respect of transactions carried out for the investor. Accordingly, in the absence of an express assumption of liability by the buy-side firm, it ought to be assumed that in the ordinary course of business, unless expressly disclaimed, sell-side firms may be regarded as willing to deal with the unidentified principal, and thus, that the investment firm did not become personally liable on the contract concurrently with the unidentified principal or principals.[54] The ordinary course of business between the agent and the third party does not change because the investment manager is part of a financial services group that also operates brokerage or dealer businesses. The bank or broker-dealer owned investment management firm will have to be directed and controlled in its own right and accordingly, its commercial purpose is not different from that of a stand-alone investment management firm.

1.49 In the event of long-term or complex bilateral transactions, the sell-side firms will typically not transact unless a modicum of due diligence in relation to the purported principal has been carried out to satisfy that the investor meets its credit (p. 23) and other requirements, such as financial crime-related requirements, for doing business. Where market anonymity is desired, buy-side firms may identify clients for which trades have been transacted by referring to code names, provided that the client's actual identity to which the code relates has been communicated to the counterparty's credit, legal or compliance function, who will not use the information other than for risk management purposes.

1.50 A principal is said to be 'undisclosed' if the third party is not, and reasonably ought not to be, aware that the agent is acting pursuant to an agency relationship, rather than as principal. If a principal—or, to be more precise, the fact that the contract is made pursuant to an agency mandate—is undisclosed at the time of contracting, the contract is made with the agent, who is personally liable on it, and can sue on it, even to recover the principal's loss by way of damages.[55] However, under common law, unlike under the laws of most civil law jurisdictions, the fact that the principal was undisclosed at the time the agent made the contract does not exclude the principal from the contract, who is liable and entitled, and may intervene to sue and may be sued. According to Lord Lloyd of Berwick in *Siu Yin Kwan v Eastern Insurance Co Ltd*:[56]

> For present purposes the law can be summarised shortly. (1) An undisclosed principal may sue and be sued on a contract made by an agent on his behalf, acting within the scope of his actual authority. (2) In entering into the contract, the agent must intend to act on the principal's behalf. (3) The agent of an undisclosed principal may also sue and be sued on the contract. (4) Any defence which the third party may have against the agent is available against his principal. (5) The terms of the contract may, expressly or by implication, exclude the principal's right to sue, and his liability to be sued. The contract itself, or the circumstances surrounding the contract, may show that the agent is the true and only principal.

1.51 The third party may use all the defences, including set-offs and other matters personal to the agent, which had already arisen, whether on the original account, and whether previously or subsequently to the original transaction against the agent prior to the discovery of the principal, and is discharged by payment to the agent prior to such time. But if the principal intervenes, the third party should no longer pay the agent.[57] Intervention is subject to the general rule that nothing must prejudice the right of the third party to sue the agent if the third party so (p. 24) wishes.[58] The law is unsettled whether the right of the agent, upon discovery of the undisclosed principal, to sue the principal excludes further action against the agent, or vice versa. *Bowstead & Reynolds on Agency* offer the following thoughts:

> [T]he governing principle could be regarded either as one of merger or as one of election. If it is one of merger, manifestation of choice to sue one or the other would have no relevance; but a judgment against one would discharge the other, and where it is against the agent, even where it was taken without knowledge of the principal. If the principle is the broader one of election, the third party has an election or choice as to with whom he wishes to regard the contract as having been.

When he has manifested this choice he cannot thereafter change course. Until he realises the existence of the undisclosed principal, of course, he is not able to make a valid election, for on general principles a choice cannot be exercised by one who does not know that he has it. Though the narrower, merger principle predominates, the election approach has been taken in some cases, including the *United Australia* case itself.[[59]] A compromise position is that judgment is the only true election.

2. Apparent authority

1.52 Without prejudice to the agent's liability to the principal for doing so, if an agent acts outside its actual authority, the doctrine of apparent authority operates to confer agency powers on an agent if the principal, by words or by conduct, represents or permits it to be represented that the agent has actual authority, and the third party relies on the representation or conduct.[60] The principal's 'representation' may be express (through written or spoken word), implied from a course of dealing, or made by permitting the agent to act in some way in the conduct of the principal's business with other persons.[61] The representation is ordinarily understood to have to be one of fact, not of law, but the decision in *Kleinwort Benson Ltd v Lincoln County Council* [62] suggests that the distinction between mistake of fact and law will need to be reconsidered.[63]

1.53 Investment managers and brokers belong to the category of agents who ordinarily have apparent authority because a third party may rely on their having authority usual to a person in that position.[64] Nevertheless, no act of the investment firm will be binding on the investor if the third party is on notice that the act exceeds (p. 25) the investment firm's agency authority.[65] The concept of 'notice' is fluid, but in commercial cases tends to tilt towards protection of the third party, as the doctrines of constructive and presumed notice appear to be excluded from the doctrine of apparent authority.

1.54 It follows for commercial agency transactions that the third party does not have a duty to research the agent's authority if there is prima facie apparent authority. However, this does not hold true unabated. The third party cannot rely on apparent authority in circumstances where a reasonable person must have been suspicious to the extent that further enquiries would have been appropriate.[66] The operation of these principles imply that a third party contracting with an investment firm that is trading within boundaries that are usual for the type of investment service ordinarily carried on by that investment firm will not normally have a duty to enquire whether the investment firm has actual authority to enter into the particular contract for the investor, unless there are circumstances that ought to give rise to suspicion or there are further circumstances giving grounds for suspicion.[67]

1.55 There is a question to what extent the doctrine of apparent authority repairs deficiencies in the authority of the agent to enter into a transaction, if the deficiency is caused by a lack of legal capacity of the principal either to delegate the authority to enter into the transaction in question to the agent, or even to enter into the transaction outright. This might occur whether the principal who does not have capacity to perform a certain act purported to give actual authority to perform that act, or not. The capacity of a legal person to enter into a transaction normally depends on the laws under which it is organized. It has been settled under English law that, if the agent is acting on behalf of a company and the act (p. 26) of delegation to the agent (or the transaction itself) is *ultra vires*, the act of delegation or the transaction shall be binding on the company, nevertheless.[68] The decisions in the local authority cases concerning over-the-counter (OTC) swap transactions, however, demonstrate the risk of transacting with a person—not a company—that does not have the capacity to enter into that type of transaction. The swap transactions were void *ab initio* and unenforceable,[69] although restitutionary remedies are available,[70] albeit the ability to recover interest in respect of payments made and repaid was denied.[71] It is not clear whether apparent authority of an investment firm to enter the swaps would have bound the local authorities, notwithstanding the fact that the swaps were ultra vires. However, based on *Kleinwort Benson*,[72] it could be argued plausibly that a representation of law, rather than of fact, should not prevent the creation of apparent authority. It appears irreconcilable to distinguish between legal person that are companies, and other legal persons, to the extent that both equally partake in commercial transactions.

1.56 The legal capacity of a trustee to enter into a transaction is not determined by the terms of the trust, but by the position of the trustee as a legal or natural person per se. A trustee, unlike an agent, incurs personal liability to third parties, as s/he acts as principal in relation to matters concerning the trust.[73] If the trustee is a company, the principles of company law apply *mutatis mutandis* to the question whether the trustee has incurred liability for the acts of the agent, if the transaction in question is ultra vires. Nevertheless, an act *ultra vires* might undermine the trustee's right to be reimbursed from the trust property, or to use the trust (p. 27) property to discharge any liabilities incurred as trustee.[74] The other party to the transaction with the trustee will not have rights against the trustee personally on the contract, but will be entitled by subrogation to the trustee's indemnity.[75] If the agent binds the trustee to a transaction that exceeds the authority of the trustee under the terms of the trust, whether on actual or apparent authority, the resulting contract may be binding on the trustee personally, but neither the trustee, nor the contracting party, will have recourse against the trust property.[76]

3. Disposition of property

1.57 The principles of agency law also operate on the disposal or acquisition of property by agents on behalf of a principal,[77] but these principles are not immediately relevant in the context of the agency acts in relation to financial assets. First, the contract made between the investment firm, acting on behalf of the investor, and the third party in respect of the sale or purchase of publicly traded fungible financial assets does not operate to pass property. Contracts for the sale of fungible financial assets are not prima facie specifically enforceable. Damages ought to be an adequate remedy in most circumstances, as money should enable the aggrieved party to buy substitute financial assets in the markets. Second, financial assets and cash are account-based assets and, therefore, transfers or receipts pursuant to obligations arising under the contracts made by the investment firm, acting on behalf of the investor, are carried out by the investor's custodian under the account agreement between the investor and the custodian.[78] The property rights in financial assets are not passed by the agent. That does not mean that the client agreement between an investor and an investment firm or bank acting as broker or custodian, and, therefore, as fiduciary, does not operate to create equitable proprietary interests for the investor.[79]

4. Warranty of agency authority

1.58 Every person who purports to act as agent is deemed, by reason of conduct, to represent that they are in fact fully authorized so to act, except to the extent that authority is expressly disclaimed or the third party knew, or ought to have known, that the authority did not in fact exist.[80] The representation is treated as an implied (p. 28) warranty, that is, the liability incurred is contractual.[81] The basic warranty so implied by law is that the agent has authority from its principal to enter into the transaction. Warranties that the principal is solvent and will perform the contract, or that the agent has authority to perform the contract, are not implied. Difficulties might arise in cases where the principal has purported to give actual authority but does not have the capacity to perform the act. The agent might be held liable, even though the act would be a nullity if done by the principal directly so that, arguably, there is no loss caused by the lack of authority.[82] However, the warranty is not implied where the representation is one of law, rather than fact. If the confusion over the existence of authority is due to an honest mistake of law, such as the true construction of a trust deed, it would not be within the scope of the warranty.[83] In the event that the agent exceeds actual authority, but the principal nevertheless is liable based on apparent authority, it would seem that, though there is a breach of warranty, practically, the third party cannot prove loss.[84] In summary, in the context of investment services, these principles imply that, every time an investment firm enters into a transaction as disclosed agent, the investment firm is deemed to represent that it has authority to do so—that is, to enter into the transaction but no more—which representation is treated as a warranty.

1.59 A breach of an agent's warranty of authority entitles the third party to compensation for losses in accordance with the general principles of contract law.[85] The test is first whether the losses are reasonably foreseeable as not unlikely to arise from the breach, and second whether the loss in question falls within the scope of the warranty, which is a question of construction, in particular against the commercial expectations that are common in the relevant market.[86] If it has been established that the plaintiff is entitled to compensation for a particular loss, damages must be assessed. In contract, the general rule is that the plaintiff must be put in a position s/he would most likely have been in had the contract been performed.[87] Thus, in a claim against an investment firm for breach of warranty of authority, the third party would be entitled to be compensated to the extent that it receives the difference between the position it is in and the position it would have been in had the representation been true.[88] This means that where the investor is insolvent (p. 29) or the contract is unenforceable, only nominal damages are due, because if the investment firm had in fact had authority the third party would not have had redress against the principal either.[89]

5. Conflict of laws

1.60 Investment firms based in the United Kingdom access trading venues in many different jurisdictions. In that case, although the internal agency relationship is governed by the law that applies to the mandate,[90] the law that applies to the rights and liabilities that may or may not arise between the investor as principal and the third party following the purported exercise of agency authority by the investment firm may be a different law. Logic suggests that this law, in most cases, will be the law of the trading venue, as the law of the trading venue would typically govern the transactions that are executed in, with, or through that venue.

1.61 Nevertheless, whether an agent has the power to bind a principal to a contract made by that agent on behalf of the principal with a third party is a matter that is explicitly excluded from the scope of the EEC Convention on the Law Applicable to Contractual Obligations, as incorporated in the law of the United Kingdom by the Contracts (Applicable Law) Act 1990 Commencement (No 1) Order.[91] Under English principles of conflict of laws, the external aspects of the agency relationship, in general, are governed by the law of the contract concluded between the agent and the third party.[92] Article 11 of the Hague Convention on the Law Applicable to Agency incorporates a different principle. It provides that, as between the principal and the third party,

> the existence and extent of the agent's authority and the effects of the agent's exercise or purported exercise of his authority shall be governed by the internal law of the State in which the agent had his business establishment at the time of his relevant acts. However, the internal law of the State in which the agent has acted shall apply if … (b) the third party has his business establishment or, if he has none, his habitual residence in that State; or (c) the agent has acted at an exchange or auction …

(p. 30) Trading venues will want to ensure that an investment manager has authority to trade by reference to the law of the trading venue. The English law principle permits just that.

E. Glossary

1.62 This Glossary aims to define certain key terms that are used frequently in this book.

1.63 ***Investor*** means any person, regardless of that person's client category under MiFID II,[93] who invests in a financial asset, which could be an individual, a company, or a governmental agency, or it could be a scheme that acts as intermediary investor to end-investors, such as a pension fund, an insurance company, or a collective investment scheme. However, the term 'investor' does not include an investment firm that acquires a financial asset as part of its trading book. The professional intermediation by an investment firm as principal facilitates the buying and selling of certain financial assets by investors. Accordingly, the trading book of that investment firm—including the trading book of any brokerage business to the extent that it is used to fill client orders as principal—essentially forms a market and should not be treated as a portfolio of investments.

1.64 A ***trading book*** is the portfolio of financial assets acquired by an investment firm or bank with the purpose to profit from the spread between the bid and ask prices, or to hedge against a certain risk the investment firm is exposed to as part of the trading book. The term 'trading book', as used in a regulatory context in relation to a firm's business or exposures, refers to the firm's proprietary positions in financial instruments that are held for resale and/or are taken on by the firm with the intention of achieving short-term profit from actual and/or expected differences between their buying and selling prices, or from other price or interest-rate variations, including positions arising from matched-principal broking and hedging activities. In addition, exposures (due to: unsettled securities transactions; free deliveries; OTC derivative instruments; repurchase agreements and securities lending transactions; and fees, commission, interest, and dividends) and margin on exchange-traded derivatives, which are directly related to these positions, are part of the trading book.[94]

(p. 31) **1.65** ***Client*** means an investor as client of an investment firm, including dealers, that is, firms that deal on own account with an investor. MiFID I implemented, and MiFID II continued, a division of client relationships into client 'categories' to recognize that investors have different levels of experience, knowledge, and expertise. There are three regulatory categories: 'retail clients', 'professional clients', and 'eligible counterparties'. A ***retail client*** is a client who is not a 'professional client'.[95] A ***professional client*** is defined by reference to Annex II of MiFID II as 'a client who possesses the experience, knowledge and expertise to make its own investment decisions and properly assess the risks that it incurs'.[96] Annex II provides certain qualitative and quantitative criteria and, accordingly, the following institutions are considered to be per se professional clients if they carry out investment services or activities and regardless of whether they are regulated in the European Union or outside: (1) banks, investment firms, other authorized or regulated financial institutions, insurance companies, collective investment schemes and management companies of such schemes, pension funds and management companies of such funds, commodity and commodity derivatives dealers, and other institutional investors. In addition, (2) large companies,[97] (3) national and regional governments, including public bodies that manage public debt at national or regional level, Central Banks, international and supranational institutions such as the World Bank, the IMF, the European Central Bank (ECB), the European Investment Bank (EIB) and (4) other similar international organizations are per se professional clients. An ***eligible counterparty*** is defined in Article 30 of MiFID II as an investment firm, a bank, an insurance company, an Undertakings for Collective Investments in Transferable Securities (UCITS) or its management company,[98] a pension fund or its management company, other financial institutions authorized or regulated under EU law or under the national law of a Member State, a national government and its corresponding offices including public bodies that deal with public debt at national level, a central bank, and supranational organizations. Article 71(1) of MiFID II Delegated Regulation (EU) 2017/565 permits Member States to include professional clients of categories (1) to (3) above to the category of 'eligible clients'.

(p. 32) **1.66** ***Investment*** and ***invest*** mean the acquisition of a financial asset without reference to the way the acquisition is financed, the intended holding period, or whether the acquisition is risky or not. In economic terms, a distinction may be made between *investing, speculating*, and *gambling*. It may be argued that 'investing' is 'a method of purchasing assets to gain profit in the form of reasonably predictable income (dividends, interest, or rentals) and/or appreciation over the long term' and that 'it is the definition of the time period for the investment return and the predictability of the returns that often distinguish an investment from a speculation'.[99] Speculation and gambling can, economically speaking, be distinguished as 'an assumption of risk for no purpose but enjoyment of the risk itself' (a gamble) and a transaction 'undertaken in spite of the risk involved because one perceives a favourable risk-return trade-off' (speculation), so that to 'turn a gamble into a speculative prospect requires an adequate risk premium to compensate risk-averse investors for the risks they bear'.[100] Indeed, the investor's rationale and purpose for, and the investor's understanding of the investment risk of, an acquisition may affect the scope of the duty of care of an investment firm that is engaged by an investor with a view to the acquisition of a financial asset. In very plain terms, an investor who acquires a risky asset in the mistaken belief that it is a risk-free asset may have recourse against the intermediating investment firm for breach of duty of care. Nevertheless, strictly in the context of the execution steps that must be taken to implement an acquisition, the act of investment is investment context agnostic. It is not relevant to the scope of the execution-related conduct and insolvency risks whether the investor, in economic terms, is investing, speculating, or gambling. Accordingly, the terms 'investment' and 'investing' mean the acquisition of a financial asset without reference to the way the acquisition is financed, the intended holding period, or whether the acquisition may be considered 'speculative' in nature or even a gamble.

1.67 ***Financial asset*** means:

(a) *debt and equity interests*, also referred to as 'primary financial assets'; [101]

(b) interests in *collective investment schemes* and *securitization vehicles*, also referred to as 'secondary financial assets'; [102]

(c) *derivatives*, that is, bilateral agreements, excluding bilateral agreements that constitute (fungible) debt or equity instruments, for the sale and purchase of a financial asset, financial reference rate, or financial index on a forward or option basis or combination thereof, also referred to as 'meta financial assets'; [103]

(p. 33) (d) *securities financing transactions*, that is, bilateral agreements whereby one party—the financing party—transfers financial assets or cash to another party—the funded party—in return for a rate or a fee and the receipt of cash or other financial assets by way of collateral, and at the same time, usually as part of the same transaction, parties commit to return cash or equivalent financial assets and collateral at a later date. Securities financing transactions are made in the form or a repurchase agreement ('repo'), a buy/sell back transaction, a securities loan, or a funded total return swap ('liquidity swap'). [104]

1.68 ***Interest***, unless indicated otherwise, is broadly used to denote a right, claim, title, or legal share in something.[105]

1.69 ***Collateral*** or ***financial collateral*** means cash or financial assets that are used to create proprietary interests for a creditor to secure or otherwise support the satisfaction of the debt in case of default. Taking proprietary security is also known as 'collateralization'.[106] ***Initial margin collateral*** means the financial collateral that is required to be provided at the execution of the collateralized transaction. ***Variation margin collateral***, also known as *mark-to-market margin*, is the financial collateral that must be provided, or may be withdrawn, as the case may be, during the term of the collateralized transaction if the value of the financial collateral falls below, or exceeds, the agreed minimum value.

1.70 ***Investment services and activities*** is a term used within the meaning given to it in MiFID II. MiFID II distinguishes between 'investment services' and 'investment activities'.[107] The term 'investment services' denotes professional services relationships. The term 'investment activities' denotes arm's length sales relationships. 'Dealing on own account' and 'operation of a multilateral trading facility (MTF)' or 'organized trading facility (OTF)' are investment activities.[108] Accordingly, the primary investment services and activities may be summarized as follows:[109]

(a) *investment selection services*: portfolio management, investment advice, and investment research;

(p. 34) (b) *trade execution in the secondary markets*: either as a broker or as a dealer, which may include ancillary services, that is, custody services, foreign exchange dealing, secured and unsecured transaction financing, and collateral management services;

(c) *primary market offerings*: underwriting and placing of new issues of securities;

(d) *maintaining trading venues*: operating an OTF or MTF, that is, a trading facility other than a regulated exchange.

1.71 ***Investment firm*** means any firm that by way of a business carries on investment services or activities within the meaning of, and therefore must be authorized and regulated in accordance with, MiFID II. In summary:

(a) *investment managers* or *portfolio managers* are investment firms that on a discretionary, client-by-client basis invest and reinvest a portfolio of assets in accordance with a certain investment objective;

(b) *financial advisers* are investment firms that on a personal, client-by-client basis make investment recommendations, having considered their client's investment objective and situation;

(c) *brokers* are investment firms that as part of their regular business execute trades in financial assets on the instruction and for the account of clients; [110]

(d) *dealers* are investment firms that as part of their regular business execute trades in financial assets for their own account with clients, which include investors as well as other investment firms. *Market makers* are dealers who act under the auspices of a trading venue.; [111]

(e) *inter-broker/dealers* are investment firms that operate and maintain trading venues (OTFs or MTFs).

1.72 ***Bank*** is used within the meaning given to the term 'credit institution' in CRD IV[112] and CRR,[113] and therefore means any firm whose business consists of both taking deposits or other repayable funds from the public and providing loans and other forms of credit as principal for its own account, and therefore must (p. 35) be authorized and regulated in accordance with CRD IV.[114] The use of the term 'bank' is limited to refer to a firm's combined deposit-taking and credit activities. If the subject matter is investment services, the term 'investment firm' will be used, even if that firm is also a bank.[115]

1.73 ***Bank money***, ***cash***, or ***funds*** means a balance standing to the credit of a cash account maintained by a bank, regardless of the currency in which the credit balance is expressed to be payable. Tangible money, that is, coins and notes, is not a form of tender used in connection with investment transactions. The term 'cash account' is used to distinguish the account from a 'securities account' maintained by a custodian, but also because that term is slightly more neutral than the term 'deposit account', which is often used in the banking industry to connote an account in respect of which the bank does not offer payment services.

1.74 ***Central counterparty*** (***CCP***) means a firm that by way of business carries on clearing and settlement services as centralized counterparty to participants in a certain market so that the firm interposes itself through its clearing members between market participants who have concluded a contract, becoming the seller to the buyer and the buyer to the seller. Firms that are established in the EU and offer clearing services as a CCP must be authorized and regulated under the 'European Market Infrastructure Regulation'[116] (EMIR).[117] ***Clearing member*** means a firm that participates in a CCP, that is, has entered into a CCP account agreement with a CCP, so that the firm can clear market contracts it or its clients have concluded into that CCP account.

(p. 36) **1.75** In the United Kingdom the activities of a CCP is a regulated activity within the meaning section 22 of Financial Services and Markets Act 2000 (FSMA),[118] and therefore a CCP would be in breach of the 'general prohibition' of section 19 of FSMA,[119] unless authorized to carry that regulated activity on by way of a business. However, if it is a 'recognized central counterparty' (RCCP), that is the subject of a UK recognition order, or a EEA CCP or third country CCP authorized in accordance with Article 17 or 25 of EMIR, respectively, then the CCP activities are exempt from the general prohibition in respect of any regulated activity which is carried on for the purposes of, or in connection with, its recognition order or EMIR authorization.[120] The Bank of England regulates RCCPs.[121] The Treasury may make regulations setting out the requirements for RCCPs, provided that the default rules require the approval of the Secretary of State.[122] 'Default rules' are rules that provide for the taking of action in the event of a person's appearing unable, or likely to become unable, to meet his or her obligations in respect of one or more market contracts connected with the exchange or clearing house.[123]

1.76 ***Clearing*** means the process of establishing trade positions, including the calculation of net settlement obligations, and ensuring that funds and financial assets are available for settlement, including settlement of collateralization obligations.[124] The term 'clearing' is used in a variety of meanings. In respect of a central bank operated payment system, 'clearing' is the function of calculating the net payment obligations due between the members of the payment system, and the term ***clearing house*** refers to the person charged with that function, which is not necessarily the central bank. In respect of CCP systems, the term 'clearing' refers to (p. 37) the process of trade confirmation, novation, and, where applicable, netting of resulting payment and delivery obligations by way of set-off, and the term 'clearing house' refers to the CCP who assumes settlement responsibility as a principal following novation of the original contract.

1.77 ***Custodian*** means a firm that is in the business of holding, administering, and transferring financial assets, commonly referred to as ***custody services***, or ***custody***. An investment firm or bank must normally be authorized by the competent regulator to engage in custody services. In the United Kingdom the safeguarding and administering of 'investments' is specified in Article 40 RAO as a regulated activity within the meaning of section 22 FSMA. FCA has made rules in Client Assets Sourcebook (CASS) 7 that authorized firms that have permission to carry on the safeguarding and administration of investment will need to comply with.[125] Annex I, Section B, of MiFID II provides that custody services, defined as '[s]afekeeping and administration of financial instruments for the account of clients, including custodianship and related services such as cash/collateral management and excluding maintaining securities accounts at the top tier level' is an ancillary service under MiFID II.[126] An 'ancillary service' is a service for which a firm cannot be authorized independently under MiFID II, but if a firm is authorized otherwise to offer or engage in one or more investment services and activities listed in Section A of Annex I to MiFID II, such as offering brokerage services, that firm may in addition be authorized to offer ancillary services and passport those under MiFID II on a cross-border or -branch basis.[127]

1.78 ***CSD*** stands for a ***central securities depository*** which must be authorized and regulated in accordance with the Central Securities Depository Regulation (CSD Regulation).[128] The services of a CSD as the top-tier depository for securities that (p. 38) are issued by the original issuer are not investment services or activities, nor ancillary services under MiFID II. Annex I, sub B, of MiFID II excludes maintaining securities accounts at the top-tier level from the concept of 'custody services'. The objective of a CSD is to operate a securities settlement system within the meaning of the CSD Regulation.

Accordingly, a CSD provides securities accounts, central safe-keeping services, and asset services, which may include the administration of corporate actions and redemptions and plays an important role in helping to ensure the integrity of securities issues by ensuring that securities are not accidentally or fraudulently created or destroyed, or their details changed. A CSD can hold securities either in physical form (but immobilized) or in dematerialized form (only as electronic records). The precise activities of a CSD vary based on jurisdiction and market practices. A CSD may maintain the definitive record of legal ownership for a security; in some cases, however, a separate securities registrar will serve this notary function.[129]

The activities of a CSD would qualify as 'safeguarding and administration of investments' as specified in Article 40 RAO as a regulated activity within the meaning of section 22 FSMA. Therefore, a CSD would prima facie be in breach of the 'general prohibition' of section 19 of FSMA unless authorized to carry on that regulated activity by way of a business. Similar to CCPs, however, 'recognized CSDs' who are subject to a recognition order, 'EEA CSD' and 'third country CSDs' authorized in accordance with Article 16 or Article 25 of the CSD Regulation, respectively, are exempt from the general prohibition of section 19 of FSMA in respect of any regulated activity which is carried on for the purposes of, or in connection with, its recognition order or authorization under the CSD Regulation.[130]

1.79 ***Book-entry securities*** means interests arising pursuant to a balance standing to the credit of a securities account administered by a custodian or a CSD in accordance with the terms and conditions of a securities account agreement. The introduction of CSDs to hold and transfer securities through immobilization or dematerialization of the original bearer or registered securities has resulted in the transformation of property held by the investor directly in the original securities of the issuer to property held by the investor in a balance standing to the credit (p. 39) of a securities account. Accordingly, the rights to securities do not necessarily represent rights to the originally issued securities.[131] The term 'original securities' is used to refer to securities of the issuer that form the subject matter of a balance of a securities account.

It is not uncommon to refer to balances standing to the credit of a securities account as 'intermediated securities' to reflect that the interests arising pursuant to the securities account balance derive from the original securities. In this book, the term 'book-entry securities' is preferred because that term firmly identifies the interests arising pursuant to the account balance as separate and distinct from the original securities. The term 'intermediated securities' suggests that the custody chain somehow creates rights for the end-investor in the original securities, which it only does if supported by a statutory scheme.[132] The intermediate account providers do not typically bring about a relationship of any description between their account holders and the next intermediary in the chain. The fact that an intermediate account holder is bound on behalf of its account holders to hold a pool of original or book-entry securities for the collective benefit of all account holders does not mean that the account holders, individually or collectively, can exercise rights directly in respect of the pool. Usually, the account holder can only exercise rights against the account provider, notwithstanding that these rights create proprietary interests in the assets held by the account provider. It would be best to refer to the rights conferred upon the account holder as 'securities entitlements'.[133] That term identifies the interest in a balance (p. 40) of an account as a bundle of distinct rights that are separate from the original securities, or indeed the next level of securities entitlements, which are held by the account provider for the benefit of its accountholders.[134] However, this is not (yet) the prevailing reference term in the English legal realm, nor in the Continental European.

Footnotes:

1 See on the concept of 'financial system', John Armour et al, *Principles of Financial Regulation* (OUP 2016) Ch 2.

2 The International Securities Lending Association (ISLA) published the Global Master Securities Lending Agreement (GMSLA), which is a document that may be used as a standard master agreement for securities lending transactions in the cross-border market. The International Capital Market Association (ICMA) has developed a standard master agreement for repo transactions in the cross-border market in conjunction with the Securities Industry and Financial Markets Association (SIFMA). The first version of the Global Master Repurchase Agreement (GMRA) was published in 1992 and followed by substantially revised versions in 1995, 2000, and 2011. The International Swap Dealer Association (ISDA) has developed the standard ISDA Master Agreement to document swap transactions.

3 The Giovannini Group, *Cross-Border Clearing and Settlement Arrangements in the European Union* (Brussels, November 2001) 56. (The consultative group chaired by Professor Giovannini was asked by the European Commission 'to address the most basic pillar of the infrastructure that supports financial markets: the system that ensures that securities exchanged within the European economy are properly delivered from the seller to the buyer.' The report lists a number of barriers to that objective.)

4 This taxonomy and its clarification draws on Andrew Von Nordenflycht, 'What is a Professional Service Firm? Toward a Theory and Taxonomy of Knowledge-intensive Firms' (2010) 35 Academy of Management Review 155.

5 Appendix A specifies 'investment services and activities' as:

1) Reception and transmission of orders in relation to one or more financial instruments; (2) Execution of orders on behalf of clients; (3) Dealing on own account; (4) Portfolio management; (5) Investment advice; (6) Underwriting of financial instruments and/or placing of financial instruments on a firm commitment basis; (7) Placing of financial instruments without a firm commitment basis; (8) Operation of an MTF; (9) Operation of an OTF.

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 (recast), [2014] OJ L173/349 (MiFID II).

7 Regulation (EU) 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Regulation (EU) 648/2012, [2014] OJ L173/84 (MiFIR).

8 FCA, 'Wholesale Banking Supervision' (FCA, 2018), 10.

9 Edgar H Schein, *Organisational Culture and Leadership* (Wiley 2017) 6 has given an authoritative definition: 'The culture of a group can be defined as accumulated shared learning of that group as it is solving problems external adaptation [(strategy)] and internal integration [(process)]; which has worked well enough to be considered valid [to be applied] … ; this shared learning evolves into a [shared] system of believes, values, behavioural norms'. Schein identifies the content of accumulated shared learning as the basic assumptions of a group, the cultural DNA, its legitimacy derived from the previous success of that group. That also means that if the group experiences a fundamentally new situation, eg Brexit, new shared experience is built, which will influence culture.

10 Group of Thirty (G30), *Banking Conduct and Culture: A Call for Sustained and Comprehensive Reform* (July 2015) 17.

11 Although the thrust of the G30's definition is clear, culture shapes conduct, it is perhaps not clear how the reference to 'behaviour' as a force that shapes 'conduct' should be understood. 'Conduct' and 'behaviour' are not separate and distinct concepts.

12 See Prudential Regulatory Authority, Corporate governance: Board responsibilities (Supervisory Statement, SS5/16, March 2016) 7.

13 In the context of culture as a set of norms that informs or requires a certain behaviour, the PRA is possibly referring to 'ethics' rather than 'ethical behaviour'.

14 See the PRA's Rulebook, Allocation of Responsibilities, 4.1(6) and (14).

15 FCA, Individual Accountability: Extending the Senior Managers & Certification Regime to all FCA firms (CP17/25, July 2017) 2.14. See further on the role of culture in risk management, Lodewijk van Setten, 'Risk, Risk Management, and Internal Controls' in Danny Busch, Guido Ferrarini, and Gerard van Solinge (eds), *Governance of Financial Institutions* (OUP 2019) paras 9.20ff.

16 See also Schein (n 9) 14.

17 See Van Setten (n 15).

18 See: Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, as amended (Investment Services Directive) [1993] OJ L141/27, Investment Services Directive (ISD); and 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 [2004] OJ L145/1, Markets in Financial Instruments Directive (MiFID I).

19 Gerard McMeel and John Virgo (eds), *McMeel and Virgo on Financial Advice and Financial Products* (3rd edn, OUP 2014) paras 1.54–1.55, define 'financial product' slightly differently as 'a contract or contractual package marketed or retailed to a recipient … , the characteristic of which is that any proprietary interest acquired by the recipient either consists of rights to purely intangible property, or else the entitlement is purely contractual'. That definition fits any financial asset acquired by an investor pursuant to a financial service provided by an investment firm.

20 See eg FSA, Product Intervention (Discussion Paper, DP11/01, January 2011) para 2.10.

21 See eg Joanna Benjamin, *Financial Law* (OUP 2007) paras 10.76–10.78, who observed in 2007 that there 'is no significant product regulation of investment securities under FSMA', and Niamh Moloney, *EU Securities and Financial Markets Regulation* (3rd edn, OUP 2014) 825.

22 See *McMeel and Virgo on Financial Advice and Financial Products* (n 19) para 1.74.

23 See George Walker and Robert Purves (eds), *Financial Services Law* (4th edn, OUP 2018) para 19.29.

24 See arts 16(3) and 24(2) of MiFID II.

25 Articles 9 and 10 Delegated Directive (EU) 2017/593 of 7 April 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

26 A prime example of an investment product that was riddled with inherent conflicts was ABACUS 2007 AC1, a securitization product offered to institutional investors by Goldman Sachs in early 2007. It concerned a synthetic CDO. (See Chapter 2, para 2.13ff, for a description of securitization products in the form of CLOs, CDOs, etc.) Investors in notes offered by ABACUS suffered considerable losses. The US Securities and Exchange Commission (SEC) filed a complaint against Goldman Sachs, alleging that the offering materials of ABACUS failed to disclose the involvement of a third party hedge fund, Paulson & Co, who influenced the composition of the reference portfolio of ABACUS. Paulson & Co later took a short position on ABACUS. Goldman Sachs was paid a very substantial fee, $15 million, to facilitate the short. Synthetic CDOs are composed of exposures to other financial assets, including securitized products. The exposure in a synthetic CDO is created through a 'reference portfolio', which serves as the conduit for calculating the pay-out structure. This particular reference portfolio was multi-layered and complex and therefore suffered from inexact risk calculations, which meant that the fact that the reference portfolio's composition was based on the views of a third party hedge fund that was seeking to take a short position on that very same portfolio would have been material information for the long investors. In MiFID II terms, ABACUS would likely breach both disclosure and product governance requirements. Goldman Sachs settled the matter with the SEC, admitting that the marketing materials for the ABACUS 2007-ACI transaction contained incomplete information and that it was a mistake to state that the reference portfolio was 'selected by' ACA Management LLC without disclosing the role of Paulson & Co in the portfolio selection process and that Paulson's economic interests were adverse to CDO investors.

27 Although there was a legislative debate around proposals made by Parliament that the intervention powers could be used pre-emptively, on a precautionary basis, before products were marketed or sold to clients, see Moloney (n 21) 828. See also Danny Busch, 'Product Governance and Product Intervention under MiFID II/MiFIR' in Danny Busch and Guido

Ferrarini (eds) *Regulation of EU Financial Markets – MiFID II and MiFIR* (OUP 2017) para 5.41ff.

28 See art 69(2)(t) of MiFID II.

29 See for instance ESMA Decision (EU) 2018/796 of 22 May 2018 to temporarily restrict contracts for differences in the Union in accordance with art 40 of Regulation (EU) 600/2014 of the European Parliament and of the Council. ESMA reviewed the offering of contracts for the difference (CFDs) to retail investors in the EU and imposed a restriction by requiring that the marketing, distribution or sale of CFDs to retail investors be subject to: leverage limits on opening positions; a margin close out rule on a per account basis; a negative balance protection on a per account basis; preventing the use of incentives by a CFD provider; and a firm specific risk warning delivered in a standardized way.

30 See Armour et al (n 1) 267, who note that from 'an economic or functional perspective … there is little difference' between prudential regulation and product regulation.

31 Although there is a requirement that the investment product be stress-tested, since risk and return properties are central to investment in financial assets, a requirement to assess the inherent risk management properties of the investment product would probably have been appropriate.

32 Similarly, Moloney (n 21) 829.

33 Articles 16(3) and 23 of MiFID II, and arts 33–35 of Delegated Regulation (EU) 2017/565.

34 Article 24(10) of MiFID II, and art 27 of Delegated Regulation (EU) 2017/565.

35 Article 25 of MiFID II, and arts 54–57 of Delegated Regulation (EU) 2017/565.

36 Recital 71 of MiFID II makes it clear that the product governance obligations for distributers 'should apply without prejudice to any assessment of appropriateness or suitability to be subsequently carried out by the investment firm in the provision of investment services to each client, on the basis of their personal needs, characteristics and objectives'.

37 See Armour et al (n 1) 266, observing that the product governance rules target 'firm rent-seeking'. See also *McMeel and Virgo on Financial Advice and Financial Products* (n 19) para 1.78, who observe that the complexity and consequent lack of intelligibility of financial products suggests that 'there is a need for regulation of contract terms and product particulars in addition to controls on the quality of advice, in order to tackle the problem of "asymmetric information" between providers and consumers'.

38 Chapter 3 addresses default risk-mitigating aspects of the financials assets and money holding infrastructure.

39 Report to the G-20 Finance Ministers and Central Bank Governors, Guidance to Assess the Systemic Importance of Financial Institutions, Markets and Instruments: Initial Considerations (prepared by the Staff of the International Monetary Fund and the Bank for International Settlements, and the Secretariat of the Financial Stability Board, October 2009) 5–6.

40 Access to and cost of funding increasingly appear to be seen as the essence of systemic risk, see Jan H Dalhuisen, *Dalhuisen on Transnational Comparative, Commercial, Financial and Trade Law – Volume 3* (Hart 2016) n 5 at 468 (questioning whether that covers the full picture). See also Steven Schwarcz, 'Systemic Risk' (2008) 97 *Georgetown Law Journal* 193, 204.

[41] See ‘The Orderly Liquidation of Lehman Brothers Holdings Inc. under the Dodd-Frank Act’ 3, 2011 *FDIC Quarterly* (Volume 5, No 2), 31, 33: ‘The Lehman bankruptcy had an immediate and negative effect on U.S. financial stability and has proven to be a disorderly, time-consuming, and expensive process’.

[42] Michael J Fleming and Asani Sarkar, ‘The Failure Resolution of Lehman Brothers’ 2014 *FRBNY Economic Policy Review* (December) 175, 185.

[43] See Mark J Roe and Stephen D Adams, ‘Restructuring Failed Financial Firms in Bankruptcy: Selling Lehman’s Derivatives Portfolio’, 2015 *Yale Journal on Regulation* (‘Lehman’s failure exacerbated the financial crisis, especially after AIG’s collapse in the days afterwards prompted counterparties to close out positions, sell collateral, and thereby depress and freeze markets. Many financial players stopped trading for fear that their counterparty would be the next Lehman or that their counterparty had large unseen exposures to Lehman that would make the counterparty itself fail. Such was the case with the Reserve Primary Fund, a money market fund that held too many defaulting obligations of Lehman. That reaction led to a further panic, a threat of a run on money market funds, and a government guarantee of all money market funds to stem the ongoing financial degradation throughout the economy’) 385.

[44] For instance, the key supervisor of the US banking system, the Board of Governors of the Federal Reserve System, adopted a rule imposing restrictions on default rights and transfer restrictions in certain derivative and securities financing contracts of systemically important banking organizations or their affiliates. Broadly similar rules have been issued by the other US bank regulators, the Federal Deposit Insurance Corporation and the Office of the Comptroller of the Currency. This rule seeks to respond to the threat to financial stability posed by such default rights in two ways. First, the rule reduces the risk that courts in foreign jurisdictions would disregard statutory provisions that would stay the rights of a failed firm’s counterparties to terminate their contracts when the firm enters a resolution proceeding under one of the special resolution frameworks for failed financial firms. Second, the rule facilitates the resolution of a large financial entity under the US Bankruptcy Code and other resolution frameworks by ensuring that the counterparties of solvent affiliates of the failed entity cannot unravel their contracts with the solvent affiliate based solely on the failed entity’s resolution. *Restrictions on Qualified Financial Contracts of Systemically Important U.S. Banking Organizations and the U.S. Operations of Systemically Important Foreign Banking Organizations; Revisions to the Definition of Qualifying Master Netting Agreement and Related Definitions*, 82 Fed. Reg. 42882 (September 12, 2017) (the Adopting Release), available at <www.federalregister.gov/documents/2017/09/12/2017-19053/restrictions-on-qualifiedfinancial-contracts-of-systemically-important-us-banking-organizations-and>.

[45] Clearing and CCP structures are discussed in Chapter 3.

[46] Investment risk is discussed in Chapter 2.

[47] See Peter G Watts (ed), *Bowstead & Reynolds on Agency* (21st edn, Sweet & Maxwell 2017) paras 1.001–1.007. (In turn, influenced by the definitions in §§1.01, 2.01, and 2.03 of The Restatement (Third) of Agency (2006). The Restatements are authoritative outlines of principles of American ‘multi-state’ common law, which are published by the American Law Institute (ALI) after extensive consultation of the American legal community by a ‘reporter’. The reporter commissioned by the ALI to take responsibility for The Restatement (Third) of Agency was Professor DA DeMott of Duke University School of Law.)

[48] *Bowstead & Reynolds on Agency* (n 47) paras 9-001 to 9-002.

[49] *Bowstead & Reynolds on Agency* (n 47) para 9-005 (citing *Montgomerie v UK Mutual SS Assn* [1891] 1 QB 370, 372 and '*The Swan*' [1968] 1 Lloyd's Rep 5).

[50] See Chapter 43, paras 4.50ff (on the implication of fiduciary duties in an agency relationship).

[51] See Chapter 3, paras 3.90ff (on investor interests in CCP cleared contracts).

[52] This is not different if the issue for interpretation is to ascertain who the contracting parties are; see Lord Bingham in *Homburg Houtimport BV v Agrosin Private Ltd, 'The Starsin'* [2004] 1 AC 715, para 9, observing that 'when construing a commercial document, in the ordinary way, the task of the court is to ascertain and give effect to the intentions of the contracting parties. Here, the task is to ascertain who, on one side, the contracting party was. But a similar approach is appropriate'.

[53] Certain monetary authorities and other investors that manage very large portfolios may not want the market to know when they are trading, to minimize market-impact costs.

[54] For the reasoning, see *Bowstead & Reynolds on Agency* (n 47) para 9-016 (observing that 'there may be cases where the third party can be regarded as being willing to deal with the principal, whoever he is', and, indeed, that 'it has been said that in an ordinary commercial transaction such willingness may be assumed by the agent in the absence of other indications', citing Diplock LJ, in *Teheran-Europe Co Ltd v ST Belton (Tractors) Ltd* [1968] 2 QB 545, 555, and Lord Lloyd of Berwick in *Siu Yin Kwan v Eastern Insurance Co Ltd* [1994] 2 AC 199, 209).

[55] *Bowstead & Reynolds on Agency* (n 47) para 8-069.

[56] [1994] 2 AC 199, 207 (see Lord Lloyd of Berwick), cited by *Bowstead & Reynolds on Agency* (n 47) para 8-069, considering Lord Berwick's summary of the leading modern formulation of the features of the doctrine of undisclosed principal, and noting that the origin of the undisclosed principal's right to intervene 'is said to lie in the right of the principal of a factor to intervene in the factor's bankruptcy, to claim his goods or the unpaid price of them; and later to sue in respect of the whole contract', as well as that the right of intervention of the undisclosed principal 'is certainly difficult to accommodate within standard theories of contract, which emphasize, even though under objective criteria, the consent of the parties'.

[57] *Bowstead & Reynolds on Agency* (n 47) para 8-109.

[58] *Bowstead & Reynolds on Agency* (n 47) para 9-012.

[59] *United Australia Ltd v Barclays Bank Ltd* [1941] AC 1.

[60] *Bowstead & Reynolds on Agency* (n 47) para 8-010.

[61] *Bowstead & Reynolds on Agency* (n 47) para 8-014 (citing *Freeman & Lockyer v Buckhurst Park Properties (Mangal) Ltd* [1964] 2 QB 480, 503, regarding a principal who permits an agent to act in the conduct of the principal's business).

[62] [1999] 2 AC 349. (This concerned a swap transaction that was entered *ultra vires*. The bank was given the right to recover the initial payment, which was made under mistake of law rather than fact, by way of restitution, on grounds that the council had been unjustly enriched. Prior to the decision in *Lincoln*, payments made under mistake of law would not have been recoverable.)

[63] *Bowstead & Reynolds on Agency* (n 47) para 8-022.

[64] *Bowstead & Reynolds on Agency* (n 47) paras 8-015, 8-024.

[65] *Bowstead & Reynolds on Agency* (n 47) para 8-047.

[66] *Bowstead & Reynolds on Agency* (n 47) para 8-048. But note Lord Neuberger of Abbotsbury in the Hong Kong Court of Final Appeal in *Akai Holdings Ltd v Thanakharn Kasikorn Thai Chamchat* (2010) 13 HKCFAR 479 at [51] onwards (noted Lee and Ho (2012) 75 MLR 91) ('Akai') deciding that once apparent authority is established, the ability to rely on the representation so made out will be lost only if the third party has actual knowledge of the lack of actual authority or if that party's belief in the agent's authority was 'dishonest or irrational' (absence of apparent benefit and known conflict of interest meant the irrationality test was met on the facts in *Akai*). *Bowstead & Reynolds on Agency* (n 47, para 8-049) observe that 'the new concept, in this context anyway, of "irrationality" was preferred to the older test of unreasonable reliance on the holding out', but also submit (para 8-050), respectfully, that 'this development is based on a misunderstanding of prior authorities and of general principle. … In short, the no-inquiries rule operates at common law only where what is sought is rescission (or other form of restitution), or, in cases of fraud, damages for reliance loss. It cannot be relied upon to make a contract. Even within the sphere of its operation, the cases conclude that, in the absence of obfuscation, the no-inquiries rule applies only to unequivocal representations, not to ones where there is ambiguity or a series of inconsistent statements.'

[67] *Bowstead & Reynolds on Agency* (n 47) para 8-053 (observing that, for example, in the area of banking practice, it would be unusual for an agent to pay the principal's money into his own personal bank account, or to use a signed blank transfer for what might well, to an outsider, be his own purposes).

[68] Article 9 of the First Directive on Company Law (First Council Directive of 9 March 1968 on coordination of safeguards which, for the protection of the interests of members and others, are required by Member States of companies within the meaning of the second paragraph of art 58 of the Treaty, with a view to making such safeguards equivalent throughout the Community (68/151/EEC), as amended, [1968] OJ L65, 8) provides that 'acts done by the organs of the company shall be binding upon it even if those acts are not within the objects of the company, unless such acts exceed the powers that the law confers or allows to be conferred on those organs', which, if implemented correctly, removes *ultra vires* as a relevant factor in a company's external relations, and thus from questions of apparent authority. See for an analysis of the implementation of art 9 into English company law, *Bowstead & Reynolds on Agency* (n 47) para 8-035.

[69] *Hazell v Hammersmith & Fulham London Borough Council* [1992] 2 AC 1.

[70] *Westdeutsche Landesbank Girozentrale v Islington London Borough Council* [1996] 1 AC 669 and *Kleinwort Benson Ltd v Lincoln City Council and others* [1998] 3 WLR 1095.

[71] *Westdeutsche Landesbank* (n 70).

[72] [1999] 2 AC 349 (a decision that concerned a swap transaction that was judged to be entered into *ultra vires* by the local authority in question. The bank was given the right to recover the initial payment, which was made under mistake of law rather than of fact, by way of restitution, on grounds that the council had been unjustly enriched. Prior to the decision in Lincoln, payments made under mistake of law would not have been recoverable on that basis).

[73] Geraint Thomas and Alastair Hudson, *The Law of Trusts* (2nd edn, OUP 2010) para 21.10 (neither the settlor nor the beneficiaries will be liable if the trustee acts as trustee) and 21.13 (it is possible for the trustee and a party with whom the trustee is transacting to agree that the trustee shall not be personally liable, or that the amount shall be limited, or that the other party shall only look to the trust assets for payment).

[74] Section 31(1) Trustee Act 2000.

[75] Thomas and Hudson (n 73) para 21.14.

[76] Thomas and Hudson (n 73) para 21.17.

[77] *Bowstead & Reynolds on Agency* (n 47) para 8-125 (noting that a principal is bound by dispositions of property made by his or her agent acting within the scope of such agent's actual or apparent authority or which are ratified) and para 8-168 (noting that, where a purported transfer of property in goods is made to the agent of a disclosed principal, and the agent receives it as such acting within its actual or apparent authority, the property in the goods is transferred to the principal if such is the intention of the parties to the transfer; the position in relation to a transfer of land would be different).

[78] See paras 6.50ff (on the discharge of payment and securities settlement obligations).

[79] These matters are discussed in Chapter 3.

[80] *Bowstead & Reynolds on Agency* (n 47) para 9-060.

[81] *Bowstead & Reynolds on Agency* (n 47) para 9-062.

[82] *Bowstead & Reynolds on Agency* (n 47) para 9-066.

[83] *Bowstead & Reynolds on Agency* (n 47) para 9-069.

[84] *Bowstead & Reynolds on Agency* (n 47) para 9-071 (noting that there is judicial authority, holding that, in case of apparent authority, there is no breach of warranty of authority at all, which can 'only be justified on the rather doubtful ground that the agent warrants that he has actual or apparent authority'). This position could change if it is accepted that apparent authority may arise in cases of mistake of law.

[85] *Bowstead & Reynolds on Agency* (n 47) paras 9-077 to 9-075.

[86] See Chapter 5, paras 5.72ff (on remoteness of damages in contract).

[87] See paras 5.93ff (on quantum of damages).

[88] See paras 5.65ff (on causation in the event of investor complaints based on breach of warranty, representation, or negligence). See *Bowstead & Reynolds on Agency* (n 47) para 9-078.

[89] *Bowstead & Reynolds on Agency* (n 47) paras 9-080 to 9-077.

[90] In almost all cases, the mandate will contain an express—'boiler plate'—choice of law provision. Under English principles of conflict of laws, the internal aspects of the agency relationship (the agent's authority as between itself and its principal) is governed by the law that governs the creation of the agency, which usually means that it will be governed by the law that is chosen to apply to the client agreement that embeds the agency authority: see Lord Collins of Mapesbury and Professor Jonathan Harris (eds), *Dicey, Morris & Collins—The Conflict of Laws* (15th edn, Sweet & Maxwell 2017), Rule 243, 33R–407. This is a common principle: see art 5 of the Hague Convention on the Law Applicable to Agency (concluded on 14 March 1978 and entered into force on 1 May 1992), which provides that the 'internal law chosen by the principal and the agent shall govern the agency relationship between them', and that the 'choice must be express or must be such that it may be inferred with reasonable certainty from the terms of the agreement between the parties and the circumstances of the case'.

[91] SI 1991/707. See *Dicey, Morris & Collins—The Conflict of Laws* (n 90) para 33-434.

[92] Note 50, Rule 244, 33R–432; for a general discussion, see paras 33-434 to 33-440.

[93] See paras 1.46ff (on client classification duties under MiFID II).

[94] Regulation (EU) 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, [2013] OJ L176/1, the Capital Requirements Regulation (CRR), provides capital requirement rules for authorized banks and investment firms and in that context, distinguishes between assets held as part of the trading book and other assets. The CRR defines 'trading book' in art 4(1)(86) as the portfolio of 'financial instruments and commodities' held 'either with trading intent, or in order to hedge positions held with trading intent'. Article 4(1)(85) defines 'held with trading intent' as: '(a) proprietary positions and positions arising from client servicing and market making; (b) positions intended to be resold short term; (c) positions intended to benefit from actual or expected short term price differences between buying and selling prices or from other price or interest rate variations'.

[95] Article 4(1)(11) of MiFID II.

[96] Article 4(1)(10) of MiFID II.

[97] A company that meets any two of the following criteria: balance sheet total of EUR 20 million; net turnover of EUR 40 million; or own funds of EUR 2 million.

[98] Interestingly, Alternative Investment Funds (AIFs) and their management companies are not listed, but presumably fall within the scope of the term 'other financial institutions'.

[99] Burton G Malkiel, *A Random Walk Down Wall Street* (12th edn, WW Norton and Co 2015) 28.

[100] Zvi Bodie, Alex Kane, and Alan Marcus, *Investments and Portfolio Management* (9th edn, Blackwell's 2011) 189 (adding that 'risk aversion and speculation are not inconsistent').

[101] Described in more detail in Chapter 2, paras 2.05ff.

[102] Described in more detail in Chapter 2, paras 2.11ff.

[103] Described in more detail in Chapter 2, paras 2.18ff.

[104] Described in more detail in Chapter 2, paras 2.20ff.

[105] This definition is inspired by *Black's Law Dictionary—Centennial Edition (1891–1991)* (West 1990).

[106] Ewan McKendrick (ed), *Goode on Commercial Law* (5th edn, Penguin Random House 2016) para 22.15, n 42, eloquently submits that the term 'collateral' should substitute the term 'proprietary security' on grounds that the term 'security' is 'not ideal, since it is used in so many senses, being applied indifferently to describe the interest acquired in the asset, the instrument creating that interest and the asset which is the subject matter of the interest', although it is also noted that 'collateral' is used to describe title transfer security arrangements.

[107] Article 1(1) of MiFID II.

[108] See Danny Busch, 'Conduct of Business Rules under MiFID I and MiFID II' in D Busch and C van Dam (eds), *A Bank's Duty of Care* (Hart 2017) 13.

[109] See art 4(1)(2) in conjunction with Appendix I, sub A, of MiFID II.

[110] See the definition of 'execution of orders on behalf of clients' in art 4(1)(5) of MiFID II, which includes the issue of financial instruments by the investment firm or bank to a client.

[111] See the definition of 'dealing on own account' in art 4(1)(6) of MiFID II, which refers to 'trading against proprietary capital', and 'market maker' in art 4(1)(7), which means a dealer 'who holds himself out on the financial markets on a continuous basis as being

willing to deal on own account by buying and selling financial instruments against that person's proprietary capital at prices defined by that person'.

112 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 (Capital Requirements Directive IV or CRD IV).

113 Investment firms authorized under MiFID II may be 'institutions' within the meaning of art 4 CRR.

114 Article 3(1)(1) CRD IV, which cross-refers art 4(1) CRR. It means that to be required to be regulated as a bank under CRD IV, the firm must engage both in a deposit-taking and in a lending business. In addition to authorization to engage in core banking business, a credit institution may apply under CRD IV for authorization to engage in activities specified as items (3) to (15) of the list in Annex I, which are, in summary: financial leasing; money transmission services; the issuing of payment instruments, such as credit cards and travellers' cheques; the issuing of guarantees and commitments; dealing on own account or for the account of customers in securities, currencies, and financial derivatives; the underwriting of securities issues; investment banking; portfolio management and investment advice; the safekeeping and administration of securities; and credit reference services.

115 Banks authorized under CRD IV may also be authorized under CRD IV to provide MiFID II investment services in which case MiFID II's conduct of business supervisory framework applies to that part of the bank's business, see art 1(3) MiFID II and Recital (38) of MiFID II (observing that banks authorized under CRD IV are not required to seek separate authorization under MiFID II to engage in investment services or activities, but can be authorized under CRD IV provided that the competent authority, before granting an authorization under CRD IV, verifies that the bank complies with the relevant provisions of MiFID II).

116 Regulation (EU) 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories, commonly referred to as 'EMIR'.

117 See the definition of 'central counterparty' in art 2(1) of EMIR, and the requirement for CCPs to be authorized in art 14(1) of EMIR.

118 Section 22 of FSMA defines a 'regulated activities' as 'an activity of a specified kind which is carried on by way of business and: (a) relates to an investment of a specified kind; or (b) in the case of an activity of a kind which is also specified for the purposes of this paragraph, is carried on in relation to property of any kind.' Section 22(1) in conjunction with s 22(5) FSMA provides that a 'regulated activity' is an activity of a kind specified in an order made by the Treasury. The Treasury specified the regulated activities in the Financial Services and Markets Act 2000 (Regulated Activities) Order, SI 2001/544 (RAO). Depending on the structure, the CCP services would be within the scope of art 14 RAO (dealing in investments as principal), art 21 RAO (dealing in investments as agent), or art 25 RAO (arranging deals in investments).

119 Section 19 provides that '[n]o person may carry on a regulated activity in the United Kingdom, or purport to do so, unless he is (a) an authorised person; or (b) an exempt person on grounds that the central counterparty engages in a regulated activity', which is known as the 'general prohibition'.

120 Section 285(3A) to (3C) of FSMA.

[121] Section 285A(2) of FSMA.

[122] Section 286(2) FSMA.

[123] Section 286(3) FSMA. Chapter 3, para 3.89ff, addresses the special market-default insolvency regime in pt VII of the Companies Act 1989 that sets aside certain insolvency provisions which would otherwise apply to 'market contracts' and 'qualifying collateral arrangements'.

[124] See the definition of 'clearing' in art 2(3) of EMIR.

[125] Article 40 of FSMA 2000 (Regulated Activities) Order 2001, SI 2001/544.

[126] Annex I, s B, under (1) of MiFID II. Investment firms within the meaning of 4(1)(1) of MiFID II which are authorized to provide the ancillary service referred to in point (1) of s B of Annex I to MiFID II (safekeeping and administration of instruments), which deal on own account, underwrite, or place instruments, or who are permitted to hold money or securities belonging to their clients and which for that reason may not at any time place themselves in debt with those clients are 'institutions' within the meaning of CRD IV and CRR and therefore subject to prudential supervision under CRD IV and CRR, see art 3(1)(3) CRD IV in conjunction with art 4(1)(2)(c) CRR.

[127] Article 34 and 35 of MiFID II.

[128] See art 2(1)(1) of Regulation (EU) 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) 236/2012 (CSD Regulation). Section A of the Annex to the CSD Regulation specifies as the 'core services of central securities depositories': (1) Initial recording of securities in a book-entry system ('notary service'); (2) providing and maintaining securities accounts at the top-tier level ('central maintenance service'); and (3) operating a securities settlement system ('settlement service').

[129] See the definition of 'central securities depository' in Bank for International Settlements (BIS) and International Organization of Securities Commissions (IOSCO), 'Principles for financial market infrastructures' (BIS Committee on Payment and Settlement Systems and IOSCO Technical Committee, April 2012) para 1.11. See also, Christophe Bernasconi, Richard Potok, and Guy Morton, 'General Introduction: Legal Nature of Interests in Indirectly Held Securities and Resulting Conflict of Laws Analysis', in Richard Potok (ed), *Cross-Border Collateral: Legal Risk and the Conflicts of Law* (Butterworth/LexisNexis 2002) 2.18 and 2.19 (particularly at n 32).

[130] Section 285(3D) to (3E) and (3G) of FSMA.

[131] Compare the definition of 'book-entry securities' in art 1(g) of Directive 2002/47/EC of the European Parliament and of the Council of 6 June 2002 on financial collateral arrangements ('Collateral Directive'): ' "book entry securities collateral" means financial collateral provided under a financial collateral arrangement which consists of financial instruments, title to which is evidenced by entries in a register or account maintained by or on behalf of an intermediary'. The words 'title to which' could be interpreted to refer to title in the original securities, but should not be interpreted as such. See further the slightly more adaptable definition of 'book-entry securities' embedded in the definition of 'transfer order' in Directive 98/26/EC of the European Parliament and of the Council of 19 May 1998 on settlement finality in payment and securities settlement systems ('Settlement Finality Directive') in respect of securities credited to a securities account: 'an instruction by a participant to transfer the title to, or interest in, a security or securities by means of a book entry on a register, or otherwise'.

[132] Eg the Dutch Book-Entry Securities Act (*Wet giraal effectenverkeer*, Stb 1977, 386) provides that account holders of a custodian that participates in the dedicated CSD are direct co-owners in the pool of securities held by the CSD, even though the custodian, and not its account holder, is the participant in the CSD. The fiction only holds up to the account holders at the level of the custodian. If that participating custodian acts as sub-custodian to another custodian, that other custodian as client of its sub-custodian will still be deemed to be a direct co-owner in the pool held by the CSD, but not that other custodian's account holders. See on the Dutch Book-Entry Securities Act generally, Victor P.G. de Serière, *Rechtspersonenrecht – Effectenrecht* (Asser Serie, Wolters Kluwer, 2018), paras 640ff.

[133] In accordance with the terminology adopted by the leading modern statutory restatement of the law applicable to securities accounts, Revised art 8 (1994 Revision) of the US Uniform Commercial Code, particularly Part 5, §§8-501 to 8-511.

[134] See Chapter 3, paras 3.46ff below (on rights arising pursuant to securities accounts).