INSTITUTE FOR LAW AND FINANCE

GUIDO FERRARINI

CONTRACT STANDARDS AND THE MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID): AN ASSESSMENT OF THE LAMFALUSSY REGULATORY ARCHITECTURE

INSTITUTE FOR LAW AND FINANCE
JOHANN WOLFGANG GOETHE-UNIVERSITÄT FRANKFURT

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PROF. DR. THEODOR BAUMS
PROF. DR. ANDREAS CAHN

INSTITUTE FOR LAW AND FINANCE

JOHANN WOLFGANG GOETHE-UNIVERSITÄT

SENCKENBERGANLAGE 31

D-60054 FRANKFURT AM MAIN

TEL: +49 (0)69 / 798-28941

FAX: +49 (0)69 / 798-29018

(INTERNET: HTTP://WWW.ILF-FRANKFURT.DE)

Guido Ferrarini

Contract Standards and the Markets in Financial Instruments Directive (MiFID): An Assessment of the Lamfalussy Regulatory Architecture

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Contract Standards and the Markets in Financial Instruments Directive (MiFID): An Assessment of the Lamfalussy Regulatory Architecture

Guido Ferrarini [*]

I. The Overall Setting

1. Paper's Aims

In this paper, I analyse the conduct of business rules included in the Directive on Markets in Financial Instruments (MiFID)[1] which has replaced the Investment Services Directive (ISD).[2] These rules, in addition to being part of the regulation of investment intermediaries, operate as contractual standards in the relationships between intermediaries and their clients. While the need to harmonise similar rules is generally acknowledged, in the present paper I ask whether the Lamfalussy regulatory architecture, which governs securities law making in the EU, has in some way improved regulation in this area. In section II, I examine the general aspects of the Lamfalussy process. In section III, I critically analyse the MiFID's provisions on conduct of business obligations, best execution of transactions and client order handling, taking into account the new regime of trade internalisation by investment intermediaries and the ensuing competition

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*Professor of Business Law and Capital Markets Law, University of Genoa.

[1] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ L 145, 30.4.2004, p. 1.

[2] Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJ L 141, 11.6.1993, p. 27.

between these intermediaries and market operators.[3] In section IV, I draw some general conclusions on the re-regulation made under the Lamfalussy regulatory structure and its limits. In this section, I make a few preliminary comments on the relevance of conduct of business rules to contract law, the ISD rules of conduct and the role of harmonisation.

2. Relevance to Contract Law

While the rules of conduct applicable to investment intermediaries belong to regulatory law and have public law nature,[4] their relevance to contract law is almost undisputed.[5] First of all, contracts made between investors and intermediaries must comply with the conduct of business obligations applicable to the latter under regulatory law. For example, under Article 19 (7) MiFID 'the investment firm shall establish a record that includes the document or documents agreed between the firm and the client that set out the rights and obligations of the parties, and the other terms on which the firm will provide services to the client …'. The Committee of European Securities Regulators (CESR), in expressing its advice on possible implementing measures of the MiFID under the Lamfalussy procedure, suggested that these measures should cover the minimum content of the retail client agreement, including the basic agreement, agreements for

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[3] For a more comprehensive treatment of this issue, see G. Ferrarini and F. Recine, 'Testing the Lamfalussy Regulatory Structure: The MiFID and Internalisation', paper presented at the Conference on Investor Protection and Capital Markets Integration in Europe held at the University of Milan on the 11-12 November 2004 (the conference proceedings are forthcoming).

[4] See I. Koller, 'vor § 31', in H. D. Assmann and U. Schneider (eds), *Wertpapierhandelsgesetz,* 2nd ed. (Köln: Verlag Dr. Otto Schmidt, 1999), 665, para. 16, who defines those included in Article 11 ISD as purely supervisory rules; J. Köndgen, 'Rules of Conduct: Further Harmonisation?', in G. Ferrarini (ed), *European Securities Markets: The Investment Services Directive and Beyond* (London-The Hague-Boston: Kluwer Law International, 1998), 117, who speaks of 'transforming duties of contractual or precontractual origin into public-law obligations'.

[5] See M. Tison, 'Conduct of Business Rules and their Implementation in the EU Member States', in G. Ferrarini, K. J. Hopt and E. Wymeersch (eds), *Capital Markets in the Age of the Euro: Cross-border Transactions, Listed Companies and Regulation* (London-The Hague-Boston: Kluwer Law International, 2002) 76, raising the question 'whether the drafters of the [ISD] intended solely to underline the protection of investors as an indirect side-effect of the protection offered through the supervision and deontological enforcement of the rules of conduct, or whether, on the contrary, the directive effectively envisaged having rules of conduct drawn up by the Member States on which investors could directly rely against the investment firm'; and answering the same as follows: 'In view of the clear wording of the preamble to the ISD, the latter viewpoint must be adhered to' (the preamble referred to by the author states in its 47th recital concerning the conduct of business rules: 'Whereas one of the objectives of the Treaty is to protect investors').

trading in derivatives and agreements for portfolio management.[6] Similarly, the conduct of business obligations have an impact on the formation of the client agreement to the extent that Article 19 (3) MiFID requires 'appropriate information' to be provided to clients or potential clients 'so that they are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered …'. Also in this respect, CESR suggested detailed implementing measures, underlying the different nature of the information to be included in the client agreement and the pre-contractual information to be provided under Article 19 (3), and remarking that under Article 19 (2) 'all information …addressed by the investment firm to clients or potential clients shall be fair, clear and not misleading'.[7] Moreover, conduct of business obligations supplement contract terms, such as the 'suitability' standard requiring 'the investment firm to assess whether the investment service or product envisaged is appropriate for the client' (see section III, para. 2 below). In addition, regulatory obligations are considered by the courts in defining the intermediaries' duties under private law; for example, the 'best execution' provision foreseen by Article 21 MiFID (see section III, para. 3 below) will help to specify the fiduciary duties of loyalty and care.[8] Arguing differently would contradict the investor protection aims of financial markets regulation and jeopardize the harmonisation purposes of the MiFID.[9]

However, the extent to which contract law will be either influenced or transformed by the MiFID is difficult to assess in advance and will also depend on national approaches. Making a forecast from the German perspective, a scholar recently

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[6] See CESR's Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments, Consultation Paper, June 2004, 60.

[7] Ibid 54.

[8] See Köndgen, n 4 above, 121, noting: 'The statutory rules of conduct drawn up by the Member States will broaden tort liability for breach of statutory duties. Moreover, they are likely to inspire the civil courts either to add, by implication, the statutory duties to the terms of a contract or to find novel but equivalent duties of care and loyalty so as to expand liability in contract. As a matter of liability both in contract and in tort, it will no longer be possible for investment firms to disclaim their fiduciary responsibility'.

[9] See Tison, n 5 above, 76.

predicted that the MiFID's rules of conduct shall intensify the shift in focus that was set in motion by the ISD.[10] While the traditional German approach to the conduct of securities business was embodied in Section 383 et seq. of the German Commercial Code (*HGB*) concerning the commission contract (*Kommissionsvertrag*), Sections 31 et seq. of the Securities Trading Act of 1994 (*WpHG*) implemented Article 11 of the ISD with provisions closely paralleling the contractual and pre-contractual obligations foreseen by the *HGB*. Subsequently, courts and commentators focussed on the *WpHG* rather than on the *HGB*.[11] Considering that the MiFID's rules of conduct are more detailed than the those contained in the ISD, there will be a further shift towards regulatory law producing a partial 'eclipse of contract law'.[12]

3. Conduct of Business under the ISD

The ISD was adopted in 1993 to introduce a single licence for investment intermediaries and harmonise some aspects of exchange law.[13] Article 11 (1) of the ISD required Member States to draw up rules of conduct that investment firms (and banks offering investment services) should observe at all times. These rules had to take account of the professional nature of the person for whom the service was provided and to implement at least the principles set out in Article 11 which, in turn, reflected the IOSCO principles on conduct of business.[14] Therefore, the harmonisation effected by the ISD was very limited, as acknowledged by Article 11 (2) making safe "any decisions to be taken

[10] P. Mülbert, 'The Eclipse of Contract Law in the Investment-Firm-Client Relationship', paper presented at the Milan Conference cited at n 3 above.

[11] Ibid 3. For instance, the discussion concerning the banks' duty to provide information to clients focussed on Section 31 (2) of the *WpHG* rather than on pre-contractual obligations.

[12] Ibid 18.

[13] On the ISD, in general, see G. Ferrarini 'Towards a European Law of Investment Services and Institutions' (1994) 31 CMLR 1283; Ferrarini (ed), n 4 above; N. Moloney, *EC Securities Regulation* (Oxford: Oxford University Press, 2002) 355 et seq.

[14] See Ferrarini, n 3 above, 1304, stating that the ISD principles are very similar to those stated by IOSCO in December 1990, which, in turn, are similar to those adopted in the United Kingdom in March of the same year.

in the context of the harmonisation of the rules of conduct",[15] while leaving the implementation of the rules and supervision of compliance with the same to the Member States in which a service was provided.[16] This provision created a fundamental difficulty for passporting investment firms and was identified as a major weakness in the ISD: 'Investment firms are potentially subject to, at the moment, fifteen different interpretations of the general principles set out in Article 11 and the associated regulatory costs if they choose to provide investment services within all the Member States'.[17] As explained by the Commission in its Communication on Article 11, there are divergences between Member States in the level of conduct of business protection offered to retail investors, particularly in the areas of conflicts of interest, 'best execution', and conduct of business requirements for 'execution only' transactions (see section III, para. 2 below).[18] An additional problem was that Article 11 did not clarify when an investment firm could be deemed to provide services within a particular Member State and to be subject to its conduct-of-business regime.[19]

While the ISD established 'a clear general presumption in favour of the free provision of services on the basis of home country authorisation', some provisions of the same admitted 'the involvement of host country authorities in the interest of the "general

[15] An author, who had been one of the ISD drafters, excluded that Article 11 resulted in any harmonisation of conduct of business at all: C. Cruickshank, 'Is there a Need to Harmonise Conduct of Business Rules?', in Ferrarini (ed), n 13 above, 132.

[16] The Explanatory Memorandum to the original proposal, at COM (88) 778, noted that the rules of conduct were not brought within the competence of the home-country authorities for the following reason: 'At present there are considerable divergences between Member States in the content of such rules and the way in which they are applied. A considerable furher effort of harmonisation will be needed to permit the application of these rules to pass under home-country control'.

[17] Moloney, n 13 above, 399.

[18] See Commission Communication on The Application of Conduct of Business Rules under Article 11 of the Investment Services Directive, COM (2000) 722, also noting that, with respect to professional investors, national legislations result in comparable protection.

[19] See Moloney, n 13 above, 400, arguing that 'Article 11 (2) does not specify whether a physical or territorial connection between the Member State in which the recipient of an investment service is located and the investment firm, such as the temporary presence of representatives of the investment firm, is necessary before the Member State can be characterized as the Member State in which the service is provided and its rules can apply'.

good"'.[20] In particular, Articles 17 (4) and 18 (2) of the ISD provided that the host country authorities, which receive notification from a partner country's investment firm intending to establish or provide services in its territory, must, if necessary, 'indicate to the investment firm the conditions, including the rules of conduct, with which, in the interest of the general good, the providers of investment services must comply in the host Member State'. In the Commission's opinion, this wording made clear that the host authorities wishing to impose local conduct of business rules more prescriptive than the minimal harmonisation principles for conduct of business provided by Article 11 (11) could do so if this was in the interest of the 'general good'.[21] The Commission relied, in this respect, on the case law of the ECJ[22] and argued that 'in exercising responsibilities for the enforcement of conduct of business rules, host country authorities could take into account two related considerations: (1) whether or not the home state of the service provider implements conduct of business rules which offer equivalent protection; and (2) whether the imposition of host country rules is a proportionate response to preserving the underlying "general good"'.[23]

Further harmonisation was needed to reduce the cost of providing cross-border services and allow for a home country approach to conduct of business regulation. FESCO undertook preliminary work in this direction, which resulted in the publication

[20] See the Commission Communication on Article 11, n 18 above, 14.

[21] Ibid 15.

[22] See, for instance, Case C-222/95 Société Civile Immobilière Parodi v Banque H. Albert de Bary et Cie (1997) ECR I-3899, indicating that 'as a fundamental principle of the Treaty, the freedom to provide services may be limited only by rules which are justified by imperative reasons relating to the public interest and which apply to all persons or undertakings pursuing an activity in the state of destination, insofar as that interest is not protected by the rules to which the person providing the services is subject in the Member State in which he is established. In particular, those requirements must be objectively necessary in order to ensure compliance with professional rules and to guarantee the protection of the recipient of services and they must not exceed what is necessary to attain those objectives (…)'.

[23] See the Commission Communication, n 18 above, 15.

by CESR of a document on the harmonisation of conduct of business rules.[24] In this document, CESR developed common standards and rules for investor protection by specifying the basic conduct of business requirements foreseen by Article 11 ISD, with three aims in mind: (i) ensuring an equivalent degree of investor protection throughout the EEA; (ii) reducing impediments to competition and competitive distortions between investment firms; (iii) fostering co-operation between competent authorities. CESR's work on conduct of business rules no doubt influenced the formation of the corresponding provisions of the MiFID and is also likely to affect level 2 legislation in this area. However, the Directive did not incorporate CESR's standards which were to a large extent modified, so that also the MiFID's implementing measures will not necessarily reflect CESR's rules.

4. Role of Harmonisation

In order to justify regulatory harmonisation, there must be some market failure going beyond national borders and not adequately dealt with by national regulators.[25] Two main goals are pursued by harmonisation with respect to cross-border financial services: one is the reduction of transaction costs determined by uniformity of the rules; the other is the lowering of protectionist barriers. In the case of investment intermediaries, three sets of reasons are currently invoked to explain harmonisation of conduct of business rules. Firstly, reference to a single rulebook reduces transaction costs as investment services providers would otherwise have to comply with a different rulebook for each country in which they operate. Secondly, common standards and rules make it more difficult for Member States to use domestic law as a barrier to foreign

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[24] CESR, A European Regime of Investor Protection: The Harmonisation of Conduct of Business Rules, April 2002.

[25] See G. Ferrarini, 'Securities regulation and the Rise of Pan-European Securities Markets: An Overview', in Ferrarini, Hopt and Wymeersch, n 5 above, 249, citing L. White, 'Competition versus Harmonisation: An Overview of International Regulation of Financial Services', in C. E. Barfield (ed), *International Financial Markets: Harmonisation versus Competition* (Washington, DC: The AEI Press, 1996), 28.

investment intermediaries. Thirdly, if rules are uniform, regulators perform their supervisory functions more efficiently also by way of international co-operation, while finding it more difficult to protect domestic firms from foreign competitors.

However, these arguments do not always justify harmonised mandatory rules. On the one hand, transaction costs reductions can also be achieved through voluntary common standards such as those adopted by CESR in 2002. On the other, conduct of business rules supplement contract terms and can, to some extent, be departed from by the parties. As noted by American law and economics scholars: 'Legal rules exist, in part, to clarify the contractual relationships that exist between the parties; i.e., to encourage transactions by economizing on transaction costs… The rules requiring best execution supply for free certain contractual terms to everybody who buys or sells securities through an agent'.[26] Accordingly, conduct of business rules are, in part, default rules that the parties can set aside: for instance, the 'suitability' rule foreseen by Article 19 (5) MiFID does not apply to 'execution only' services, if the requirements foreseen by Article 19 (6) are complied with (see section III, para. 2 below). Another example is that of contracts with 'eligible counterparties' (Article 24 MiFID) to whom trading services (such as execution of orders, dealing on own account, and receipt and transmission of orders) can be offered by investment firms without being subject to the obligations concerning conduct of business, best execution and client order handling.

The latter provision helps to set the MiFID's provisions in context. Regulation is not justified when investors can cater to their needs, as is the case with sophisticated investors. Article 24 (2) defines 'eligible counterparties' as, amongst others, 'investment firms, credit institutions, insurance companies, UCITS and their management companies,

[26] J. Macey and M. O'Hara, 'The Law and Economics of Best Execution' (1997) 6 J. Fin. Int. 193, citing F. Easterbrook and D. Fischel, 'The Corporate Contract' (1989) 89 Col. L. Rev. 1416.

pension funds and their management companies'.[27] Article 24 (3) adds that 'Member States may also recognise as eligible counterparties other undertakings meeting pre-determined proportionate requirements, including quantitative thresholds'.[28] The regime provided for transactions with eligible counterparties by Article 24 (3) is such that the obligations indicated by Article 19 (conduct of business), 21 (best execution) and 22 (1) (client order handling) do not apply, unless the same counterparties request 'either on a general form or on a trade by trade basis' that these obligations apply (opt-in regime). If the opt-in faculty is exercised, the 'professional client' regime applies by default, unless the eligible counterparty requests an even higher level of protection and the investment firm accepts, in which case the 'retail client' regime will apply.[29] If the opt-in is not exercised, all the MiFID's obligations other than those explicitly excluded will apply.[30]

II. The Lamfalussy Regulatory Structure

1. General

The Lamfalussy Committee was established by ECOFIN on 17 July 2000 with a mandate to assess the current conditions for the implementation of securities markets regulation in the European Union. The Committee was asked "to assess how the mechanism for regulating those markets can best respond to developments, and, in order to eliminate barriers, to propose scenarios for adapting current practices to ensure greater

[27] Article 24 (2) also indicates 'other financial institutions authorised or regulated under Community legislation or the national law of a Member State, undertakings exempted from the application of this Directive under Article 2(1)(K) and (l), national governments and their corresponding offices including public bodies that deal with public debt, central banks and supranational organisations'.

[28] It is also specified that 'in the event of a transaction where the prospective counterparties are located in different jurisdictions, the investment firm shall defer to the status of the other undertaking as determined by the law or measures of the Member State in which that undertaking is established'.

[29] See CESR's Draft Technical Advice on Possible Implementing Measures of the Directive 2004/39/EC on Markets in Financial Instruments, 2nd Set of Mandates, Consultation Paper, October 2004, 55.

[30] Ibid 54: 'For example, if an investment firm holds financial instruments belonging to an eligible counterparty while providing services falling within Article 24 (1) of the Directive, the requirements relating to the holding of client financial instruments under Article 13 (7) of the Directive will continue to apply'.

convergence and cooperation in day-to-day implementation." As a result, a new structure was set up to improve the responsiveness of the European regulatory framework to developments rapidly occurring in the financial sector, by increasing the system's flexibility and the quality of regulation. New committees were also established such as the European Securities Committee (ESC) established in June 2001 with both advisory and regulatory capacities; and the European Securities Regulators Committee (ESRC) also established in June 2001 with various responsibilities including that for advising the European Commission on the detailed implementing rules needed to give effect to framework securities laws.[31]

2. Framework Principles

The Lamfalussy Committee suggested that Directives and Regulations in the securities area should include framework principles, whilst implementing powers should be delegated to a second level.[32] In the Committee's opinion, the framework principles are "the core political principles, the essential elements of each proposal": "They determine the political direction and orientation, the fundamentals of each decision". However, "level 1 principles should clearly specify the nature and the extent of the technical implementing measures that should be taken at the second level …". To clarify the distinction between framework principles and implementing measures the Committee offered two examples: one relating to the forthcoming Prospectus Directive, which would include principles on the "type of single passport" (shelf registration, definition of a public offer, role and powers of competent authorities, language regime) leaving the "contents of the prospectus" to level 2; the other concerning the conduct of business rules under Article 11 ISD: "A new text would include the basic elements of these rules … The

[31] See E. Ferran, Building an EU Securities Market (Cambridge University Press: 2004), 75 et seq.

[32] See Final Report of the Committee of Wise Men on the Regulation of European Securities markets, Brussels, 15 February 2001, p. 25.

implementing measures would contain the detailed rules that investment firms should apply in their relations with clients …".

However, even with respect to the examples made, the distinction between basic principles and detailed rules is far from clear. What distinguishes a "core political principle" from a simple rule? How far can a Directive go in specifying a principle without invading the territory of implementing measures? To help answer these questions, the Lamfalussy Report carried an Annex B including a draft "prototype Directive" formulating basic conduct of business rules. The Annex was headed: 'Selection of rules set out in FESCO's consultative paper on the harmonization of core conduct of business rules for investor protection'. Interestingly, only rules were mentioned, while the FESCO's paper and the subsequent CESR's document on the harmonization of conduct of business rules referred to both rules and standards, making the following distinction: 'The standards are intended to be the key parameters for a harmonised conduct of business regime. The rules implement the standards, clarifying their scope and practical meaning'.[33] The Lamfalussy Committee clearly intended the framework principles to be broader than CESR's standards: the principles suggested in the 'prototype directive' included both the standards and the rules found in CESR's document. This led to considerable detail in the suggested provisions, similar to that characterizing the MiFID.

In practice, the watershed between core principles and implementing rules is found at level 1 through negotiation within the co-decision procedure required for a Directive/Regulation.[34] Therefore, the question is more political than doctrinal, and entails negotiations between the Commission, the Council of Ministers, and the European Parliament. Attributing an issue to the area of core principles is relevant to the kind of

[33] CESR, n 24 above, 3.

[34] Report, n 32 above, 24.

procedure to be followed, given that level 1 Directives/Regulations are adopted through co-decision, while level 2 measures are subject to comitology. Whenever a conflict arises over a policy issue amongst Member States or interest groups, the question is likely to be treated at level 1 rather than being left to comitology, and the solutions tend to be sufficiently specific to avoid further discussion at level 2. As I argue in this paper, one of the main problems affecting European securities regulation is that framework principles are often too detailed, touching upon political issues which are frequently highly technical and ill-suited to level 1 type of legislation.

For the rest, the advantages of the Lamfalussy structure are easily described.[35] First of all, the legislative process speeds up to the extent that key Level 1 political co-decision negotiations "focus solely on the essential issues and not on technical implementing details". Moreover, flexibility does not rule out the democratic process, as the range and scope of implementing measures is determined by co-decision at Level 1. In addition, the European institutions can benefit from the technical expertise of national securities regulators. However, for these advantages to occur, core principles must cover "essential issues" and "technical details" are discussed at Level 1 only to fix the range and scope of implementing measures. Otherwise, co-decision negotiations would get embroiled in a web of technical issues for which the European institutions may lack expertise, while interest groups would try to capture individual MEPs and national Governments so as to protect their rents. No doubt, similar problems could also affect Level 2 as national Governments' officials participate to ESC, while the Commission lacks the independence from political power that distinguishes securities regulators, at least those constituted in the form of independent agencies. This poses additional questions: whether more room should be left to Level 3 and whether more independence should be guaranteed as to the formulation of implementing measures.

[35] Ibid 24 et seq.

3. Levels 3 and 4

Levels 3 and 4 of the Lamfalussy structure mainly concern the implementation and enforcement of European Directives in the securities area. Level 3 is grounded on co-operation and networking amongst national regulators through CESR. Its essence is "to greatly improve the consistency of the day to day transposition and implementation of Levels 1 and 2 legislation".[36] The national regulators acting in co-operative network have the main responsibility for this task. The role and functions of CESR are, therefore, defined as follows: (i) to produce guidelines for national administrative regulations; (ii) to issue interpretative recommendations and set common standards regarding matters not covered by EU legislation; (iii) to review regulatory practices and ensure effective enforcement; (iv) to conduct peer reviews of administrative regulation and regulatory practices. Level 4 concerns the strengthening of Community rules' enforcement: the major responsibility falls on the European Commission, even if all actors, including the regulators (as seen for Level 3), have a role to play.[37] The two levels therefore overlap, to the extent that implementation and enforcement of rules are closely intertwined. The main difference between the two levels is probably found in the responsible institutions and relevant activities: while Level 3 insists on regulators' networking and CESR, Level 4 focuses on the Commission as "guardian of the European Treaties".

This point was clarified by the Financial Services Action Plan's execution, as shown by CESR in a recent document.[38] While presenting CESR's views on how it should organize its role at level 3 under the Lamfalussy procedure, this document implicitly redefined the Committee's role and tasks with respect to those found in the Lamfalussy Report, also in light of the Commission Decision establishing CESR and the

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[36] Ibid 37.

[37] Ibid 40.

[38] The Role of CESR at 'Level 3' Under the Lamfalussy Process. Action Plan for 2005 (October 2004).

CESR's Charter. The Committee's role would concern three issues: (i) co-ordinated implementation of EU law, which includes transposing directives into national laws and applying EU law on a daily basis; (ii) regulatory convergence, i.e. establishing common approaches to facilitate harmonized implementation of EU law; (iii) supervisory convergence, i.e. co-operation amongst regulators under the European Directives/Regulations.[39] In CESR's view, therefore, both implementation and enforcement are included in its competences, which cover a broad range of issues of a regulatory and *supervisory* nature.

4. Assessing the Lamfalussy Structure

The Lamfalussy regulatory structure has been assessed by Eilís Ferran in a timely and thought-provoking volume[40] analysing EU securities markets regulation from the perspective of the Financial Services Action Plan (FSAP) in general and of the new issuer disclosure regime, as included in the Market Abuse Directive[41] and the Prospectus Directive[42], in particular. The author identifies problems 'in three key areas: the balance between regulatory harmonisation and diversity, where some recent changes may have shifted the balance too far in favour of a standardised approach; excessive reliance on regulation as the first-choice policy tool at the expense of due attention to supervision; and insufficient regards to the consequences of EU regulation on the global competitiveness of its securities markets'.[43] The present paper is in agreement with this analysis and the detailed arguments supporting it. Also the suggestion of 'a mixed strategy that combines some reliance on regulatory competition within the EU alongside

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[39] Ibid 5.

[40] See n 31 above.

[41] Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse), OJ 2003 L96/16.

[42] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading.

[43] Ferran, n 31 above, 2.

judicious use of EU regulatory powers to impose harmonised regulation in certain situations'[44] deserves support, as well as the statement that there are benefits in maximum harmonisation 'but they come at a cost, in terms of rigidity and loss of a useful stream of feedback about regulatory innovations which have been tested out at national level'.[45] Concerning the regulatory process for securities law-making in the EU, Ferran reaches the conclusion, amongst others, 'that, though not perfect, the Lamfalussy process is a step in the right direction' and should be seen 'as a pragmatic solution to a multidimensional, difficult problem', yet without uncritically accepting how it operates.[46] The author argues that the line between Level 1 and Level 2 legislation reflects political realities and is put sometimes in the wrong place if judged from a theoretical perspective. However, the system is sufficiently robust to withstand some degree of misplacement and problems will diminish as time goes on 'as the Council and European Parliament become less wary of dropping matters down to level 2 (and also to level 3)'.[47] In general terms, the author does not see a pan-European securities market regulator and supervisor as offering a superior way forward: her 'preferred option is to build upon and refine the existing regulatory and supervisory framework',[48] also being unclear whether Member States would tolerate delegating rule-making power in respect of the most controversial issues to a regulatory agency.[49]

In this paper, whilst following similar criticisms as to recent developments of EU securities regulation, I put more emphasis on the limits of the new rules particularly with regard to the MiFID, and adopt a more radical stance as to applicable remedies,

[44] Ibid 53.

[45] Ibid 55.

[46] Ibid 123-124.

[47] Ibid 124.

[48] Ibid 2.

[49] Ibid 119.

supporting the claim for a European regulatory agency (an issue which is only briefly considered in section IV below, given the paper's focus on rules of conduct[50]). I argue, in particular, that the system has gone too far by producing remarkably detailed Level 1 legislation, while regulating at levels 1 and 2 issues suitable for level 3 action. Moreover, I argue that the MiFID has resulted in substantial re-regulation of conduct of business by investment intermediaries that negatively affects private autonomy and introduces into the system rigidities contrary to the spirit of the Lamfalussy process. In a companion paper,[51] my co-author and I argue (in line with previous work on the draft Directive)[52] that a fully fledged European regulation was not needed for regulated markets while Multilateral Trading Facilities (MTFs) were not yet ripe for European harmonisation. In fact, the scope for the regulated markets' treatment in the MiFID should have been narrower, concentrating on issues for which regulatory divergences determine higher transaction costs.[53] Similar comments can be made for MTFs, also considering that MTF operations are not extensively developed across Europe, presumably as a result of the relative efficiency of stock exchange trading.[54] The present paper concludes that the Lamfalussy structure has not delivered the expected results, at least with reference to the MiFID, whilst acknowledging that this does not entirely depend on the new regulatory

[50] See, in particular, G. Hertig and R. Lee, 'Four Predictions about the Future of EU Securities Regulation' (2003) Journal of Corporate Law Studies 359-377, who predict the creation of a European Securities Commission despite objecting to it in theory.

[51] See G. Ferrarini and F. Recine, n 3 above.

[52] See G. Ferrarini, 'Pan-European Securities Markets: Policy Issues and Regulatory Responses' (2002) 3 European Business Organization Law Review 249-292.

[53] Regulated markets are already subject to regulation and supervision in all Member States, and no clear reasons are found for systematic harmonisation across Europe. Differences in regulation between the Member States do not appear to cause greater transaction costs to stock exchanges' users, except for clearing and settlement systems in respect to which the case for legal harmonisation has been repeatedly advanced. Moreover, there is no clear protectionism of national exchanges by the Member States suggesting adoption of European rules, also considering that anticompetitive behaviour would be contrasted by the antitrust provisions of the Treaty.

[54] Therefore, the reasons for harmonizing their regulation are unclear, unless reference is made to the need to provide a level playing field to all trading systems (stock exchanges, MTFs and "systematic internalizers"). However, this need was felt by the incumbent exchanges more than by the new trading systems and the new rules were to some extent inspired by the former to counter competition by the latter.

framework, but on the resistance of EU institutions in shifting regulatory power below level 1.

III. The MiFiD's Rules of Conduct

In this section, I critically analyse the MiFID's provisions which directly concern conduct of business by investment intermediaries, such as those on conflicts of interest, honesty and fairness of intermediaries, suitability of investment services and products, best execution of transactions, and prompt and fair handling of client orders.

1. Conflicts of Interest

Amongst the general provisions concerning the 'operating conditions for investment firms' (Chapter II of the MiFiD), those on conflict of interest are included in Article 18 and appear linked to the 'organisational requirements' foreseen by Article 13 (3).[55] Firstly, conflicts of interest that arise in the course of providing investment and ancillary services should be identified by investment firms. Secondly, these conflicts should be managed by investment firms in compliance with the relevant organisational requirements. Thirdly, where the organizational requirements are not sufficient to reasonably prevent the risk of damage to client interests, conflicts of interest should be disclosed to the client before undertaking business on her behalf (Article 18 (2)). This type of regulation is not new. Already in the ISD conflicts of interest were dealt through organisational requirements and rules of conduct[56]. The fact that transparency is a 'last resort' measure assumes that clients, including retail clients, are able to assess the risk of

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[55] Article 13 (3) provides: 'An investment firm shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in Article 18 from adversely affecting the interests of its clients'.

[56] See Moloney, n 13 above, 536 et seq; B. Rider, Conflicts of Interest: An English Problem?, in Ferrarini (ed), n 4 above, 149.

damages potentially deriving from conflicts of interest; it also assumes that investors spend time in analysing the information at issue, an assumption not easily accepted. [57]

Those included in Article 18 are no doubt framework principles that require further specification. Accordingly, Article 18 (3) foresees the adoption of implementing measures by the Commission. CESR, in its draft advice to the Commission, has proposed more detailed rules than those included in its 2002 document, for example with reference to 'measures to assure independence'[58]. In CESR's opinion, the organizational arrangements to be maintained by investment firms should include the separation of at least the persons engaged in certain activities (proprietary trading, portfolio management, corporate finance) by information barriers ('Chinese walls'). However, the investment firm would be admitted to show that it has implemented alternative arrangements to prevent conflicts of interest from adversely affecting the interests of clients. Moreover, CESR suggested indicating other measures to provide an appropriate degree of independence to persons engaged in different business activities. These measures would include separating supervision on different activities within the firm; making the remuneration of relevant persons principally engaged in one activity independent of the remuneration of relevant persons principally engaged in the other activity; etc.

CESR's proposals are well grounded and would allow for the flexibility required by fast changing financial services. It is difficult to see, however, why similar provisions should be adopted at level 2 of the Lamfalussy structure, rather than being left to level 3 action by regulators, as the technical character of the questions at issue and the organisational choices involved would suggest. Moreover, supervision should have a greater role than regulation in this area, given the wide discretion left to investment firms

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[57] On the MiFID's approach to investor choice and empowerment, see N. Moloney, 'Promoting the Retail Investor: The EU's Emerging Stategy and Conduct of Business Regulation', paper presented at the Milan Conference, n 3 above, finding in the Directive 'a retail investor regime that intervenes only lightly in the investor/investment firm relationship' (at 42).

[58] CESR, n 6 above, 41.

as to their organisational arrangements. The main reason for adopting detailed rules at level 2 appears to be that of enhancing the harmonisation of conduct of business, as level 3 measures would not be binding on Member States. It needs to be shown, however, that flexible rules such as those proposed by CESR will effectively result in a uniform treatment at European level, while uniformity will also depend on supervisory co-ordination within CESR.

2. General Obligations

Amongst the provisions to ensure investor protection (Chapter II, Section 2), Article 19 specifies the conduct of business obligations applicable to investment firms under the general clause fixed by its first paragraph: 'Member States shall require that, when providing investment services and/or, where appropriate, ancillary services to clients, an investment firm act honestly, fairly and professionally in accordance with the best interests of its clients (…)'. The subsequent paragraphs state the principles concerning information to clients, suitability of the investment service or product, 'execution only' services, documentation and reporting.

These principles are set at a fairly general level (with the exceptions indicated below) and will be further detailed at level 2 along the lines already suggested by CESR in its draft advice. Also the suitability standard is fixed at a general level by Article 19 (4) which requires investment firms providing investment advice or portfolio management to obtain from its client or potential client the information (as to his knowledge, experience, financial situation and investment objectives) needed to recommend to the same 'the investment services and financial instruments that are suitable to him'; and by Article 19 (5) which requires investment firms providing services other than those just indicated to ask the client or potential client to provide similar information 'so as to enable the investment firm to assess whether the investment service or product envisaged is

appropriate for the client'[59]. Greater specification is found in Article 19 (6) concerning 'execution only' services. When providing investment services that only consist of execution and/or reception and transmission of client orders, investment firms shall be allowed not to obtain the client's information or make the determination as to suitability under para. 5 of the same Article, if the following conditions are met: (i) the services relate to shares admitted to trading on a regulated market, money market instruments, bonds or other forms of securitised debt (excluding those embedding a derivative), UCITS and other non-complex financial instruments; (ii) the service is provided at the initiative of the client or potential client; (iii) the client has been clearly informed that the suitability rule does not apply; (iv) the investment firm complies with its obligations as to conflicts of interest.

These detailed requirements clearly exceed the boundaries of the framework principle's notion. They were included in the MiFID for the simple reason that the treatment of 'execution only' services was highly controversial at the time of the Directive's drafting. The divide between Member States (with the UK supporting a liberal treatment that other States rejected) was reflected by the discussion between European institutions. The Commission's original proposal referred basic suitability requirements also to execution only services, while Parliament defended investor choice as to low-cost execution services[60]. In its first reading, Parliament removed the suitability requirement from the treatment of those services, so as to allow investors to make independent investment decisions based on their own research and use low-cost execution services protected by background protections such as contract requirements, product regulation, disclosure, etc. A similar approach was supported by the market, so

[59] Article 19 (5) adds the following: 'In case the investment firm considers, on the basis of the information received under the previous paragraph, that the product or service is not appropriate to the client or potential client, the investment firm shall warn the client or potential client. This warning may be provi ded in a standardized format'.

[60] Moloney, n 57 above, 39.

that the Council's Common Position removed the suitability requirement for execution only services, whilst introducing the detailed regime that we now find in the MiFID. Article 19 (6), therefore, embodies a compromise: firstly, best execution and fair trading requirements always apply; secondly, execution-only services may only be provided at the initiative of the client, a requirement the compliance with which may be difficult to monitor; thirdly and 'paternalistically', threshold requirements as to the 'non-complex' nature of investments have been imposed.[61] From the present paper's perspective, not only controversial issues tend to receive detailed consideration at Level 1, but the relevant discussion leads to compromises which are either difficult to enforce or lack a clear rationale. It is enough to reflect on the notion of 'non-complex' financial instrument, which is difficult to define and not necessarily relevant to investor protection (as an investor's understanding of a given instrument is not necessarily correlated to its 'complexity'[62]).

For the sake of completeness, Article 20 should also be mentioned dealing with the case of an investment firm receiving an instruction to perform investment or ancillary services on behalf of a client through the medium of another investment firm. In a similar case, the 'performing firm' is entitled to rely on client information transmitted by the 'instructing firm', in particular to assess the suitability of the investment service or product to the client; likewise, the 'performing firm' can rely on the recommendations in respect of the service or transaction that have been provided to the client by the 'instructing firm'. Accordingly, the 'instructing firm' remains responsible for the information transmitted or the advice given, whereas the 'performing firm' is responsible for the compliance with the other provisions of Title II ('Authorisation and Operating Conditions for Investment Firms) of the MiFID.

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[61] Ibid

[62] For example, investing in shares does not always require less sophistication and understanding than buying a derivative.

3. *Best Execution*

Article 21 tackles the controversial issue of best execution within the new regulatory framework of trading activities, which allows for 'internalisation' of orders[63] and implicitly forbids 'concentration rules', i.e. rules requiring brokers to execute their client orders concerning listed securities only in regulated markets.[64] The best execution principle is formulated by Article 21 (1) in wide terms as follows: 'Member States shall require that investment firms take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account prices, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction'. This provision attracts at least two preliminary comments. Firstly, its ample formulation deserves approval, as it is widely acknowledged that order execution should be assessed not only in terms of price, but also on the basis of different criteria such as size of the order, speed of execution, etc., as foreseen by the provision at issue.[65] Secondly, the best execution principle supplements contract terms and, therefore, the parties are free to regulate order execution differently; in particular, the client can give 'specific instructions' to the investment firm and the latter is bound to comply with them.[66]

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[63] Internalisation is defined as 'the situation in which a bank or a broker executes *retail* client orders *in-house*, that is either by acting as a principal and executing them against its own positions or by sending them to an affiliated market maker': R. Davies, A. Dufour and B. Scott-Quinn, 'The MiFID: Competition in a New Equity Market Regulatory Structure', paper presented at the Milan Conference, n 3 above, 6. The MiFID narrowly defines the 'systematic internaliser' as 'an investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside a regulated market or an MTF' (Article 4 (1) No 7).

[64] Similar rules were allowed under Article 14 ISD: see Ferrarini, 'The European regulation of Stock Exchanges: New Perspectives' (1999) 36 Common Market law Review 569-598.

[65] See Macey and O'Hara, n 26 above.

[66] See n 26 above and accompanying text.

The regulatory system concerning the execution of transactions will be profoundly affected in those countries where concentration rules are still in force (like France, Italy and Spain). While concentration of trades in regulated markets offered a relatively easy way to best execution, the freedom granted to intermediaries by the MiFID requires careful analysis of best execution criteria for compliance and enforcement purposes. Article 21 was to some extent inspired by those jurisdictions, like the UK, where the trading of listed securities is already subject to a principle of freedom. Also in the US, best execution has always played a central role, deriving from the common law agency duty of loyalty rather than from regulatory fiat; however, the SEC and Congress gave practical implementation to this requirement through the establishment of the National Market System,[67] while self-regulatory organisations have adopted rules guiding their members to obtain best execution of customer orders. In contrast, the absence of an integrated market in Europe creates further regulatory problems as the same security might be traded in multiple venues based in different jurisdictions.

Article 21 (1) defines best execution broadly, making reference to various aspects of trade execution other than price. This is undoubtedly correct, even though assessing such a broad concept of best execution in individual cases may be difficult. It is not easy, for example, to compare price data with those concerning speed of execution and settlement. Therefore, choosing between best price and high speed of execution may be hard in some cases depending on the type of client, transaction and financial instrument. Yet, a narrow reading of best execution requirements that focuses, for instance, on transaction price and (monetary) cost of execution, would unduly restrain trading freedom and negatively affect competition between trading venues. As a result, legal systems must choose between a broad notion of best execution diluting the same to the

[67] See SEC, Market 2000. An Examination of Current Equity Market Developments, January 1994, Study V, 2.

point of making it almost meaningless and a narrow concept which would likely benefit the incumbent markets limiting the development of new trading venues.[68]Also the concentration rules in force in some Member States, while restraining competition, found support on grounds of best execution and fair trading as they made compliance easier and monitoring less costly.

The MiFID's treatment of best execution is a response to similar difficulties. On the one side, Article 21 (1) enounces a broad concept that is consistent with the Directive's liberalisation goals as to the market for trading venues. On the other, the subsequent paragraphs specify the best execution concept narrowing its scope and making its impact on competition less effective. Article 21 (2) limits the exercise of discretion by intermediaries asking investment firms 'to establish and implement an order execution policy to allow them to obtain, for their client orders, the best possible result in accordance with paragraph 1'. Article 21 (3) requires the order execution policy to include 'information on the different venues where the investment firm executes its client orders and the factors affecting the choice of execution venue'. The same policy 'shall at least include those venues that enable the investment firm to obtain on a consistent basis the best possible result for the execution of client orders". These provisions might be enforced in the Member States so as to protect regulated markets and MTFs against internalisers. Para. 3, in particular, appears as intended to protect the incumbent exchanges which would generally provide the 'consistent basis' needed to assure best execution of client orders. Furthermore, this paragraph requires investment firms which foresee in their order execution policy the possibility that client orders may be executed outside a regulated market or an MTF to inform their clients about it and obtain their

[68] See J. Macey and M. O'Hara, 'The Law and Economics of Best Execution" (1997) 6 Journal of Financial Intermediation 188 arguing that "well-meaning attempts to mandate best execution as a consumer-protection device run counter to attempts to make markets less centralised and more competitive" and that "this difficulty makes best execution both un-wieldly and unworkable as a mandated legal duty: pursuing a narrow concept of best execution may make markets less competitive".

express consent before proceeding to execute their orders outside a regulated market or MTF (this consent may be obtained also in the form of a general agreement). Therefore, best execution is regulated in a way that, while leaving intermediaries free to choose (and clients free to give them different instructions), potentially favours the incumbents rather than the new trading venues. This was probably intended as a "compensation" for countries losing through the MiFiD the possibility to maintain concentration rules. It is also likely that these countries will try to interpret the new provisions in ways that could narrow its scope and limit its impact on competition. After all, Article 21 is loose enough to allow room for manoeuvre in one sense or the other, depending on where its provisions are implemented and enforced.

4. Order Handling

Article 22 includes order handling rules. The framework principle is stated by paragraph 1, asking Member States 'to require that investment firms authorised to execute orders on behalf of clients implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the trading firm'. This provision is complemented by a time priority requirement fixed by the same paragraph.[69] Paragraph 2 takes care of limit orders[70] concerning shares admitted to trading on a regulated market which are not immediately executed under prevailing market conditions. The fact that these orders are kept secret by intermediaries receiving the same may deprive the market of important information on overall trading interests with respect to a given security and excludes the possibility for other intermediaries to transact against the relevant orders. In order to improve market transparency and openness, Article 22 (2) requires investment firms to make the orders in

[69] See the second sentence of Article 22 (1): 'These procedures or arrangements shall allow for the execution of otherwise comparable client orders in accordance with the time of their reception by the investment firm '.

[70] A limit order is an order to buy or sell at a specific price, as opposed to a market order, which is an order to buy or sell at the best price available in the market: see J. Coffee and J. Seligman, *Securities Regulation. Cases and Materials* (New York, N.Y.: Foundation Press, 2003), 653.

question public (unless the client expressly instructs otherwise) in a manner which is easily accessible to other market participants. This provision was inspired by US regulation and, like the latter, intends to allow for price improvements in the client's interest: the Order Handling Rules adopted by the SEC in 1996 include a 'display rule' (Rule 11AC1-4) under which dealers who accept limit orders and specialists must display any customer's limit order, including their full size, when the order is placed at a price superior to the market maker or specialist's own quotation.[71] Therefore, if the prices quoted by market makers left an artificially wide spread, a new source of competition would be introduced by allowing public customers to introduce price quotations that would narrow the bid/ask spread. As a result, brokers holding market orders from their clients would be required by their duty of best execution to execute their trades against these limit orders[72]. In addition, the Order Handling rules give an alternative to the market-maker that did not want to improve its quotation: it could send the limit order to an ECN or a market-maker that would comply with the display rule.

Similarly, Article 22 (2) is directed to generate price improvements by making public and therefore accessible to other investors those limit orders which are not immediately executed by the internalisers receiving them. The means for making public the orders at issue are not specified. Therefore, also trade information and execution systems other than regulated markets and MTF could be used by internalisers: for example, a bilateral system operated by the same internalising firm or a trade execution system operated by an information provider. However, Article 22 (2) further specifies that "Member States may decide that investment firms comply with this obligation by transmitting the client limit order to a regulated market or MTF". This specification is apparently justified by the aim to assure

[71] Ibid.

[72] Ibid, where the following example is made: '…if the market maker's quotation were $18 bid and $19 asked, a customer might place a limit order with this market-maker to buy at 18.50, and this would improve the market-maker's bid quotation to $18.50 bid and 19 asked …'.

that the relevant orders are made public and accessible in an effective way. However, Member States could be led by protectionism and exploit this option simply to protect their domestic markets.

Article 22 is, therefore, open to criticism on grounds similar to those concerning other MiFID's provisions. While its first paragraph includes a rather uncontroversial framework principle as to order handling in general, its second paragraph tackles an issue which is highly technical and ill-suited for discussion at level 1 of the Lamfalussy procedure. Moreover, the provision adopted, being inspired by US legislation, is unprecedented in Europe. The Member States already allowing for internalisation of share trading by investment intermediaries do not foresee anything like the US display rule in their domestic legislations, while the Member States forced by the MiFID to introduce internalisation lobbied for a similar rule to protect domestic stock exchanges and brokers against the large investment banks' internalising share trades. Under the MiFID's display rule, limit orders by equity investors will either improve the internalisers' quotations or be disclosed to the market. Furthermore, Member States deleting concentration rules will likely require that limit orders be sent to regulated markets and MTFs in an effort to protect the same from the domination of mainly Anglo-American investment banks. While the political implications of the display rule are quite clear, its impact on European markets is difficult to predict; also the US precedent may be of limited value given the different structure of US and European securities markets, and the existence of a National Market System in the US. In Europe, equity markets are, to some extent, still fragmented along national borders, while the MiFID's display rule by allowing for some discretion in its implementation generates doubts about the effectiveness of harmonisation and the regulatory bite of Article 22

IV. **Conclusions**

This paper has shown that the main goals of the Lamfalussy architecture have not been reached by the MiFID's rules of conduct. Level 1 provisions are too detailed and deal with very technical issues, contrary to Lamfalussy's original suggestions[73]. The implementing measures are too specific and substantially contribute to the re-regulation of business conduct, while leaving little room for standards at level 3. As a result, conduct of business rules have possibly become more uniform, but also more abstract and rigid. In addition, substantial compromises have been made on core level 1 provisions, diminishing their regulatory bite and intrinsic logic. Interest groups have played an important role at level 1 exerting their pressure on the Commission, Council and Parliament. This may explain why the MiFID and its rules of conduct were ultimately received with approval by the markets and the Lamfalussy exercise was seen as a political success, leading to complex regulations being adopted in a fairly short time. However, the cost paid by EU securities regulation is substantial in terms of rigidity, complexity and politicisation, while the effectiveness of harmonisation still needs to be proven. It is fair to add that the problems examined throughout this paper do not necessarily derive from the Lamfalussy architecture, but were also created by the political actors' willingness to treat the most controversial regulatory issues at level 1, adding to the complexity and ineffectiveness of primary securities legislation. It is also worth considering that moving to level 2 some of the relevant issues would not have substantially diminished the political influence on the rule setting process, given the nature of comitology and the ESC's composition.

From a theoretical perspective, these problems could be solved if two basic conditions were satisfied. Firstly, the co-decision procedure should always be limited to framework principles, in the narrow sense of core political principles including a broad delegation to implementing measures. This would be no doubt difficult to obtain in practice; yet, European institutions, politicians and interest groups should come to realize that reducing the scope of

[73] See, for similar comments, Inter-Institutional Monitoring Group, Third Report monitoring the Lamfalussy Process, Brussels, 17 November 2004, 19.

level 1 legislation is the only practicable way to a consistent and effective EU securities regulation. Secondly, implementing rules should be adopted by an independent regulatory agency created at EU level (along lines which would not be manageable to analyse within the confines of the present paper), operating in lieu of the Commission and in co-operation with CESR. A similar body should comply with strict regulatory standards requiring, amongst others, that market failures be properly identified and rules justified as an appropriate reaction to similar failures. Compliance with these conditions should also assure that harmonisation is limited to cases where national regulators are unfit to deal with cross-border market failures. In the end, these two conditions respond to the core problems identified throughout this paper, such as the political interference with rule setting in highly technical areas and the excessive reach of EU securities regulation determined by political rather than economic considerations. Far from being a panacea, a European independent agency could help to build the EU securities regulation on sounder grounds in areas (like rules of conduct) clearly in need of harmonisation. In other areas, where the need for uniformity is not so apparent or regulatory competition is preferable, a similar agency could curb the development of further regulation if appropriate incentives were created in the law to this effect[74]. Moreover, mechanisms of consultation and political accountability could assure that the interests of market participants and investors are appropriately considered before taking regulatory action.

[74] For similar suggestions, see L. Zingales, 'The Costs and Benefits of Financial Market Regulation' (April 2004) ECGI - Law Working Paper No. 21/2004, http://ssrn.com/abstract=536682, 54, proposing to create a new Government agency dedicated to estimate the costs and benefits of any new proposed regulation.

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