RIGA GRADUATE SCHOOL OF LAW

The notion of reverse solicitation within the realm of financial services

MASTER'S THESIS

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DECLARATION OF HONOUR:

I declare that this thesis is my own work, and that all references to, or quotations from, the work of others are fully and correctly cited.

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ABSTRACT

The objective of this thesis is to analyse the scope and current restrictions of the reverse solicitation regime vis-à-vis European financial services law. Given the reliance on ambiguous terminology, ill-defined concepts and inconsistencies throughout MiFID II, the analysis throughout the work concludes that the concept of reverse solicitation in its current form cannot be reliably utilised by third-country financial service providers due to numerous inadvertent non-compliance risks. The study concludes that the current reverse solicitation regime needs to be heavily revised to allow for a sufficient degree of legal certainty.

Consequently, the thesis also puts forth a number of much-needed improvements in terms of the concept of reverse solicitation in efforts to provide for a solution to the plethora of shortcomings currently haunting MiFID II.

SUMMARY

The scope of the research deals with the notion of reverse solicitation stemming from one of the cornerstone legal instruments vis-à-vis European financial services law, i.e., MiFID II. A review is thus undertaken to deduce whether the concepts used in setting up the reverse solicitation regime are defined to a sufficiently concise degree to mitigate issues pertaining to legal certainty and limit regulatory arbitrage. Moreover, the work attempts address whether the concept in its current form provides for far too many restrictions in relation to entities seeking to utilise the reverse solicitation regime on a permanent basis.

Given that failure to comply with the rigid scope of the notion of reverse solicitation could be particularly devastating to entities operating in the highly-regulated realm of financial markets and services, entities must ensure compliance to avoid regulatory sanctions. However, MiFID II is plagued by a great deal of issues due to its failure to define some of the most pertinent aspects to be taken into account by non-EU financial service and product providers when engaging with European retail and professional clients.

Consequently, the scope of the reverse solicitation regime is placed under closer scrutiny. This refers to, *inter alia*, the limitation of the reverse solicitation regime exclusively in relation to third-country entities, with undertakings established within the Union, and thus licenced pursuant to EU law are excluded from the scope of the reverse solicitation framework. Subsequently, the author performs a review of service recipient categorisation rules. Despite appearing to be of no importance at a first glance, it soon becomes clear that MiFID II must undergo significant changes. Consequently, analysis in respect of client categorisation benefits the former part of the thesis, whereby a number of proposals for the revision of MiFID II are set forth.

Moreover, further inconsistencies are pointed out in relation to the provision of additional services on the basis of reverse solicitation. Also in this regard in-depth analysis must be undertaken in efforts to address a seemingly trivial issue. However, as has been determined by the author's analysis pertaining to the exact scope of the reverse solicitation regime, the notion of "new categories" is of equal importance. Notwithstanding the failure among legal scholars to reach a consensus on the proper interpretation of the marketing restrictions stemming from MiFID II, coupled with discrepancies within the text of the Directive itself, the author thus attempts to develop a coherent approach in determining the exact scope of the marketing regime. Where third-country entities already face a stringent regulatory framework, even the tiniest of carve-outs granted to these undertaking must be celebrated. Nonetheless, the analysis conducted in relation thereto might not necessarily have provided for a concrete answer, yet again illustrating the weak degree of legal certainty at the disposal of entities incorporated outside the border of the Union.

Subsequently, the analysis is followed by considerations in relation to the main principles of the regime. For one, reverse solicitation requires that clients approach service providers on their "own exclusive initiative". This phrase in and of itself is distinctly vague, and provides for a number of implied restrictions in terms of marketing activities that non-EU service providers may perform when relying on the reverse solicitation framework.

The ongoing confusion in terms of how liberally the marketing regime may be interpreted starkly emphasises the weak points of the MiFID II regime, as non-EU investment firms seeking access to European markets and clients appear to be facing a worrying number of undertakings of one and the same concept. Under these circumstances third-country financial

service providers appear to be stripped of even the most basic levels of legal certainty, thus dealing a strong blow to entities that would otherwise seek access to the lucrative European financial market.

Given that reverse solicitation is not necessarily a unique concept stemming from only MiFID II, the AIFMD too is assessed to allow one to more precisely establish the particular boundaries of the marketing regime. In assessing the AIFMD regime, however, one is faced with the same widespread use of ambiguous terms. In fact, whereas reverse solicitation is expressly provided for under MiFID II, AIFMD lacks even such elementary provision.

Subsequently, by taking into account results derived from in-depth analyses of concept relevant for the MiFID II reverse solicitation regime, the thesis is concluded by setting forth areas of the MIFID II framework in need of urgent revision. By incorporation both problem areas highlighted by ESMA, and taking into account additional shortcomings that have emerged as a result of the examination of various MiFID II and AIFMD concepts, the author thus proposes a comprehensive set of changes to be addressed by the successor of MIFID II. It is thus also submitted that failure to bring about the respective changes will likely bar third-country firms from enjoying at least a basic level of legal certainty in rendering services on the basis of reverse solicitation.

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ABBREVIATIONS

Alternative investment fund	AIF
Alternative investment fund manager	AIFM
Court of Justice of European Union	CJEU
Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities	UCITS
Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers	AIFMD
Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments	MiFID II
European Commission	EC or Commission
European Securities and Markets Authority	ESMA
European Union	EU or Union
Financial Conduct Authority	FCA
Proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment funds	Proposal
Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations	Rome I
Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters	Brussels I bis
Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments	MiFIR
Treaty on the Functioning of the European Union	TFEU
United Kingdom	UK

INTRODUCTION

The realm of financial services is a particularly complex one, and not without proper reason. Not only are these services and products more often than not incomprehensible to the general public, they require at least a degree of specific knowledge to produce a return on investment. Thus, the underlying regulatory framework may well prove to be one's worst nightmare. Nonetheless, the thick layer of requirements, restrictions, thresholds, and rules are in fact much needed. The 2008 financial crisis, having just recently celebrated its tenth anniversary, proved to be a crucial turning point for lawmakers in the European Union (hereinafter: EU or Union) and elsewhere.

The 2008 meltdown highlighted the urgent need for a tide of major reforms for financial markets.[1] There is little disagreement within academic and professional circles in relation to claims that the comparatively loose regulatory framework was one of the main drivers behind the crisis by allowing the virtually turbulent markets and their participants to flourish at the expense of investors.[2] Coupled with the interconnectedness of European markets with those abroad located in jurisdictions allowing for a more relaxed approach towards financial regulations,[3] the numerous European regulatory measures aimed at reducing the outfall of the crisis evidently failed to do their part.[4] Thus, understandably, lawmakers at the EU level were finally under the pressure to step up their game and produce a new set of rules and guidelines to be abided by providers of financial services and products.

This development, *inter alia*, resulted in non-EU financial firms being brought under the scope of Union legislation within the realm of financial regulations. Consequently, via the introduction of first-generation financial law directives in the EU, third-country service providers were made subject to EU law when interacting with Union-based legal or natural persons. Moreover, European legislation imposing certain restrictions in relation to non-EU service providers became applicable.[5] As a result thereof, Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (hereinafter: MiFID II) was introduced, and nationals laws transposing it by and large became applicable on 3 January 2017, with a few exceptions pertaining to EU member states' transitional provisions pushing the application date further down the road.

With the introduction of MiFID II and other directives,[6] the current European regulatory framework vis-à-vis financial services and products attempts to further harmonise the intra-

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[1] European Securities and Markets Authority. *Report on Trends, Risks and Vulnerabilities*, p.47. Available on: https://www.esma.europa.eu/sites/default/files/library/esma50-report_on_trends_risks_and_vulnerabilities_no1_2019.pdf. Accessed 24 April 2019.

[2] Bentley J. Anderson, "An Overview of the AIFMD for US Investment Manager," *Business Law International* 17 (2016): p.42.

[3] Niamh Moloney, Jennifer Payne and Eilís Feran, *The Oxford Handbook of Financial Regulation* (Oxford: Oxford University Press, 2015), pp.786-787.

[4] Aleksandra Visekruna, "The Access to the EU Financial Market for the Companies from Non-Member States," *EU and Comparative Law Issues and Challenges Series 2* 656(2018): p.657.

[5] *Ibid*.

[6] *See also* Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities, Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers, 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

EU financial markets by setting forth a number of Union-wide restrictions and requirements, be it in terms of investor protection, capital standards or licencing prerequisites. It is thus generally the case that only qualified undertakings whose management personnel conforms to strict educational and professional standards are entitled to provide financial services to recipients within the European Union. As outlined above, in the absence of such progress, European financial markets would remain exposed to numerous vulnerabilities and entities operating therein would continue to face uncertainty during upcoming times of instability within the markets.

The current MiFID II directive replaced its predecessor, the Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (hereinafter: MiFID I), and brought about a number of crucial amendments, including the focal point of this thesis, i.e., the notion of reverse solicitation. The importance of MiFID II in terms of the realm of European financial services law must be specifically stressed, as third-country undertakings' access to the internal EU market was not dealt with under MiFID I,[7] resulting in an patchwork of various legal requirements and restrictions depending on the member state in question with a low degree of harmonisation.[8]

As per Article 42 of MiFID II, third-country financial service providers are entitled to render financial services to clients based within the EU without first having to obtain a licence or any other form of authorisation from European regulatory authorities, provided the respective clients solicited the services on their "own exclusive initiative".[9] This recent development is also often referred to as "reverse solicitation", as it calls for the service recipients to make the first step and initiate the respective transaction, instead of relying on more traditional models generally utilised across the financial services sector. This phrase will be used interchangeably throughout the thesis with references to Article 42 of MiFID II.

The scope of Article 42 is not limited to a particular category of service recipients, therefore resulting in non-EU firms catering towards either professional or retail clients being subject to one and the same conditions. Nonetheless, the scope of Article 42 is limited to the exact client-firm relationship within the confines of which the service or product was requested by the client.[10] Additionally, a further limitation is imposed in terms of advertising activities, however, as argued under the following chapters, the aforesaid notion of "own exclusive initiative" provides for an implied ban on promotional activities on the part of the service provider.

Considering the ambiguous use of language under Article 42 of MiFID II, and having regard to the heavy restrictions imposed upon third-country financial service providers, Article 42 provides for a plethora of non-compliance risks, simultaneously imposing numerous

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trading, 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, Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse, *et. al*.

[7] Visekruna, *supra* note 4, p.667.

[8] Dr. Wolfgang Weitnauer, Lutz Boxberger and Dr. Dietmar Anders, *Kapitalanlagegesetzbuch, Investmentsteuergesetz, EuVECA-VO, EuSEF-VO und ELTIF-VO [Capital Investment Code, Regulation on European venture capital funds, Regulation on European social entrepreneurship funds and Regulation on European long-term investment funds]* (Munich: Verlag C. H. Beck oHG, 2017), p.453.

[9] Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, OJ L 173, 12.6.2014. Article 42. Available on: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A32014L0065. Accessed 20 May 2019.

[10] *Ibid*.

requirements for non-Union firms. Therefore, the following thesis shall attempt to answer the research question of whether Article 42 of MiFID II, on the one hand, is too restrictive whereas its wording, on the other hand, is too ambiguous, resulting in a high risk of unintentional breach of its scope. Moreover, the thesis shall outline areas of particular concern that have to be addressed by the successor of MiFID II, and put forth a number of proposals in relation to a revised reverse solicitation regime.

First and foremost, the scope of the reverse solicitation exemption shall be examined, highlighting the heavy restrictions imposed by MiFID II. As indicated previously, Article 42 incorporates major limitations pertaining to groups of potential clients to whom financial services may be rendered on the basis of reverse solicitation. Whereas investor protection concerns are well justified when dealing with mere retail clients, imposing equally severe restrictions for professional clients, however, remains questionable and appears to run contrary to established principles of international financial law. Moreover, given the limited sphere of potential service recipients, the legal basis for setting up such stringent restrictions and creating a seemingly unfavourable environment for third-country service providers shall also be examined.

Second, the requirement for clients soliciting the respective services to have approached the service provider on their "own exclusive initiative" will also be addressed. The phrase "own exclusive initiative" in and of itself provides for a great deal of implied restrictions in terms of marketing activities undertaken by the respective service provider, as solicitation, promotion or advertisement of the respective service to the particular client will void one's ability to rely on Article 42 when interacting with European clients. Ensuring compliance with this concept in terms of record-keeping, as highlighted in this work, is particularly complex, and differs from member state to member state, thus only adding to the long list of issues pertaining to the reverse solicitation regime.

Furthermore, the term "marketing" may well be interpreted in the widest possible sense, resulting in third-country firms potentially being barred from ever rendering services once marketed in the relevant territory. This remains the case even in relation to professional clients with sufficient levels of capital to weather times of economic hardship arising out of poor investment choices or meagre performance. Additionally, a concerning degree of uncertainty as to the classification of activities falling short of marketing remains neglected under MiFID II. Whereas this uncertainty at times could be of use for third-country service providers, it still possesses unattractive risks, especially when considering sanctions for failure to comply with the respective licencing regimes.

In relation to the notions of both marketing and reverse solicitation itself, the thesis shall utilize commentaries covering Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers (hereinafter: AIFMD), as the AIFMD too provides for the possibility to rely on reverse solicitation. Nonetheless, reverse solicitation under MiFID II and AIFMD can be compared only to a certain degree due to opposite approaches incorporated under either directive. This divergence will be explained under the respective chapter.

Marketing restrictions under MiFID II further provide for the need to ascertain the particular types of investment services and instruments being rendered, distinguishing between complex and non-complex products, as well as to evaluate the risk level inherent to each product category.[11] The thesis shall consequently argue that only by performing such additional analysis can third-country entities ensure that any such marketing activities do not relate to "new categories" of services or instruments rendered, as otherwise non-EU firms would once again risk breaching Union law. Moreover, the above considerations will subsequently be analysed taking into account existing contractual relations between third-country service providers and EU nationals, a framework wherein third-country service providers might well have to exercise immense caution in efforts not to infringe upon restrictions laid down by Article 42 of MiFID II due to limitations in terms of the "relationship specifically relating to the provision of that service or activity"[12].

Consequently, the thesis will explore each of the distinct concepts of "own exclusive initiative", "marketing", "pre-marketing" and "new categories" individually in efforts to establish a more concrete scope applicable to reverse solicitation under Article 42 of MiFID II.

Should these requirements be complied with, third-country financial service providers need not seek authorization from national or European-level authorities in relation to that specific service or activity. However, the European Securities and Markets Authority (hereinafter: ESMA) has itself expressed concerns pertaining to the suitability of reverse solicitation within the overall EU legal framework on the grounds of investor protection and legal certainty. More alarming, however, remain its calls for a revision of Article 42 MiFID II. Taking into account analyses stemming from subsequent sections of the thesis, the work will thereafter attempt to evaluate the legitimacy of the ESMA's concerns and attempt to answer whether a proposed solution thereof is appropriate, if at all needed.

Having considered the above issues, the thesis shall be concluded by an analysis of the research question stated above, incorporating, *inter alia*, a review of the possibility for third-country investment firms to reliably utilise reverse solicitation on a long-term basis when dealing with intra-EU clients from compliance and risk management perspectives. In this regard, the risk of inadvertent breach of compliance obligations, as well as the long-list of limitations shall play a critical role.

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[11] European Securities and Markets Authority. *Questions and Answers on MiFID II and MiFIR Investor Protection and Intermediaries Topics: 28 March 2019*, p.104. Available on: https://www.esma.europa.eu/file/23414/download?token=dySuQzDC. Accessed 20 April 2019.

[12] *Supra* note 9.

1. THIRD-COUNTRY SERVICE PROVIDERS' ACCESS TO EU MARKETS

Against the backdrop of the pre-crisis financial services market, wherein a number of entities were not regulated at the EU level,[13] the shortcomings of MiFID I become rather apparent. Having experienced the 2008 financial instability, the need to bring as many financial service providers within the scope of upcoming European legislative revisions was of high importance. Therefore, the origins of reverse solicitation are also found during these tumulus times, with third-country service providers finally being brought under the scope of MiFID II.

Whilst one might intrinsically presume that the European financial services market is only open for entities incorporated within the borders of the EU, the current regulatory framework provides for certain access rights of third-country firms, with issues pertaining to the legal basis thereof having been resolved by the Court of Justice of the European Union (hereinafter: CJEU). Freedom of capital movement, for one, is not limited to movement within the border of the EU only, instead also covering capital flows into the common market from foreign jurisdictions.[14] Nonetheless, as per case law of the CJEU, third-country entities may not rely on the freedom of capital movement when rendering services within the Union.[15] Whereas clients' capital and other assets will certainly exchange hands at some point during the particular transaction, provisions pertaining to the freedom of services under the Treaty on the Functioning of the European Union (hereinafter: TFEU) are to be applied instead. Thus, as the scope of the respective freedom may not be extended to cover also non-EU undertakings,[16] the legal basis for such companies' activities within the Union are to be found elsewhere, leading to the application of MiFID I and MiFID II.

Non-EU entities are defined as undertakings that are not registered and licenced in either one EU member state, but, importantly, would amount to an entity subject to MiFID II or some other European financial law, had its country of incorporation been located within the borders of the Union.[17] Furthermore, MiFID II covers entities which provide financial services and products on a professional business basis.[18] Whereas the Directive does not differentiate between the legal types of the service provider, i.e. limited liability or public undertakings,[19] the provision of financial services and products "on a professional basis"[20] is of essence. Thus, the treatment of non-EU undertakings as provided for under MiFID II currently foresees, for example, the establishment of branches or full-fledged subsidiaries within the EU, or permits the reliance on the concept of reverse solicitation.

MiFID I did not permit the reverse solicitation regime, instead requiring that third-country investment service providers establish branches within the borders of the EU. Reverse solicitation, however, does not foresee such requirement to create a physical presence in the EU, instead permitting EU clients to approach the respective undertaking in their third-

[13] Moloney, *supra* note 3, p.5.
[14] Visekruna, *supra* note 4, p.659.
[15] Peter Derleder, Kai-Oliver Knops and Heinz Georg Bamberger, *Deutsches und europäisches Bank- und Kapitalmarktrecht [German and European Banking and Capital Markets Law]* (Berlin: Springer-Verlag Berlin Heidelberg, 2017), p.1927.
[16] Judgment in *Fidium Finanz*, C-452/04, EU:C:2006:631, para.25.
[17] Danny Busch and Marije Louisse, "MiFID II/MiFIR's Regime for Third-Country Firms," in *Regulation of the EU Financial Markets: MiFID II and MiFIR*, ed. Danny Busch and Guido Ferrarini (Oxford: Oxford University Press, 2017), para.10.04.
[18] *Supra* note 9, Recital 12.
[19] Moloney, *supra* note 3, p.341.
[20] *Supra* note 9, Recital 12.

country of incorporation or elsewhere outside the EU. Such uneven treatment of non-EU firms naturally resulted in financial service providers seeking access to particular member states whose national laws permitted access to third-country entities, meanwhile abstaining from entering certain national markets due to a combination of overly cautious legislators and strong national financial service providers' lobby.[21] Under circumstances of artificially limited cross-border competition with non-EU entities, service recipients suffer the most. As national undertakings enjoy protection from potential competitors, the need for entities to provide innovative financial services and products is intentionally suppressed, since the recipients of such services are unable to attain what they seek due to the potential service providers being unable to enter the local European market. Fortunately, MiFID II recognises the need for third-country entity participation within the EU financial services market. The suitability and appropriateness of the European approach towards non-EU firms under MiFID II, however, will be analysed in greater detail within this and subsequent chapters.

At the same time, however, CJEU has been rather definite in, on the one hand, acknowledging that European measures aimed at restricting or otherwise hindering third-country service providers' access to European markets comes at a detriment to clients residing in EU member states.[22] On the other hand, however, it has stipulated "that is merely an unavoidable consequence of the restriction on the freedom to provide services"[23], thus indicating that the complete abolition of any hurdles to non-EU entities might not necessarily be required.

Along with other options available to non-EU service providers, Article 39 of MiFID II provides for the right of European member states to require third-country firms to open branches within the respective member state.[24] However, this might not necessarily be the most optional route for third-country service providers, as such branches are obliged to abide by EU rules,[25] which may well carry the potential of imposing far too many limitations upon entities being used to a more lenient regulatory framework. Moreover, sufficient cross-border supervisory authority cooperation mechanisms must be set in place, and the respective entity must meet European standards in terms of capital requirements and staff standards.[26] Given these prerequisites, the establishment of branches within the EU will not be a viable option for entities established in jurisdictions whose regulatory frameworks provide for drastically different standards, as adherence to EU rules might prove to be infeasible. Moreover, branches are even less attractive to entities which interact with European clients only on occasion, since a great number of intra-EU clients would need to be services to make up for the stark setup costs.

Nonetheless, MiFID II also allows for reverse solicitation, which, importantly, is acknowledged as a right of third-country undertakings as opposed to a mere option at the discretion of individual member states' supervisory authorities. Where European member states are given the ability to choose between different legal treatments applicable to

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[21] Veil Rüdiger, "Produktintervention im Finanzdienstleistungsrecht: Systematik, Dogmatik und Grundsatzfragen der neuen Aufsichtsbefugnisse *[Product intervention in financial services law: systematic, dogmatic and fundamental issues of the new supervision powers]*," in *Bankrechtstag [Banking Law Day] 2017*, ed. Peter O. Mülbert (Berlin: De Gruyterpp, 2017), pp.166-167.
[22] Judgment in *Omega*, C-36/02, EU:C:2004:614, para.27.
[23] *Supra* note 16, para.48.
[24] *Supra* note 9, Article 39.
[25] Pierre E. Berger and Olivier Van den Broeke, "Enter Brexit: What is the Impact of the Financial Services Industry?" *International Company and Commercial Law Review* 28(2017): pp.211-212. Available on: Thomson Reuters Westlaw. Accessed 1 May 2019.
[26] *Supra* note 9, Article 39.

individual firms, the potential level of harmonisation across various EU jurisdictions remains dramatically low.

Reverse solicitation under MiFID II, on the other hand, is reserved for all third-country firms notwithstanding individual EU supervisor's reservations. In this regard one must highlight the importance of the level of harmonisation achieved by MiFID II, as the failure of MiFID I to provide for a harmonised approach towards non-EU financial service providers resulted into a highly fragmented set of rules different from one member state to the other.[27, 28] Nowadays, however, third-country financial service providers enjoy a great level or legal certainty, with reverse solicitation rules being harmonised across the whole of the EU. The current level of harmonisation, however, remains questionable and shall be assessed under the following sections.

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[27] Heinrich Nemeczek and Sebastian Pitz, "Cross-Border Business of UK Credit Institutions and Investment Firms with German Clients in light of Brexit, MiFIR and MiFID II," *European Business Law Review* 29(2018): p.443. Available on: Kluwer Law Online. Accessed 2 February 2019.

[28] European Securities and Markets Authority. MiFID II / MiFIR Third Country Regime, Placing of Trading Screens in the EU and Lack of Temporary Suspension Regime for the Trading Obligation for Derivatives, p.2. Available on: https://www.esma.europa.eu/sites/default/files/library/esma70-156-236_letter_to_the_commission_on_mifid_ii_third_country_regime.pdf. Accessed 15 February 2019.

2. NOTION OF REVERSE SOLICITATION

The concept of reverse solicitation is incorporated under Article 42 of MiFID II, which provides that

> where a retail client or professional client … initiates at its own exclusive initiative the provision of an investment service or activity by a third-country firm, the requirement for authorisation … shall not apply to the provision of that service or activity … including a relationship specifically relating to the provision of that service or activity. An initiative by such clients shall not entitle the third-country firm to market … new categories of investment products or investment services to that client.[29]

In essence, financial service providers need not seek approval or a licence from intra-EU authorities prior to rendering services to clients from within the Union, provided the client approached the firm and requested the service on their "own exclusive initiative"[30]. Article 42 therefore appears akin to the notion of passporting, further analysed under subsequent sections, while also introducing a number of particular restrictions third-country firms need to abide by.

When considering the reverse solicitation regime, provided the EU-based client approached the investment firm on their "own exclusive initiative", the provision of services to that particular client will be seen as having taken place outside the borders of the Union,[31] and thus no longer being subject to EU legislation. Granted, by falling outside the European regulatory framework, certain service recipients might inadvertently be exposed to unintended risks, as foreign jurisdictions might not provide for equally preferable investor protection mechanisms. Nonetheless, given the "own exclusive initiative" aspect of reverse solicitation, one may well presume the EU client is acting with sufficient care and thus must be aware of the inherent risks. Consequently, the service provider no longer needs to comply with EU law insofar as, for example, capital adequacy thresholds are concerned.

Whereas reverse solicitation is by no means the sole entry point to the European market for third-country entities, it provides for the smallest burden of regulatory requirements. By relying on the reverse solicitation exemption, non-EU service providers are given the opportunity to decrease the heavy cost burden generally associated with initiating business within the EU. Just to name a few, European capital and other standards could well prove to be too heavy of a burden for entities established in other jurisdictions seeking to merely perform occasional transactions with EU clients. Therefore, the reverse solicitation notion appears to achieve a somewhat level playing field.

Indeed, given that the current reverse solicitation regime does not require the establishment of branches, acquisition of licences or gaining any other regulatory green light from European authorities, it remains the most straightforward way into the European market. Nonetheless, reverse solicitation is subject to a plethora of restrictions non-EU undertakings must take into account to maintain their ability to rely on Article 42 MiFID II.

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[29] *Supra* note 9.
[30] *Supra* note 9.
[31] *Supra* note 9, Recital 111.

2.1. RETAIL OR PROFESSIONAL CLIENTS

Article 42 of MiFID II further stipulates that it applies to services rendered to either retail or professional clients. Accordingly, third-country entities need not differentiate between retail and professional clients when rendering services in accordance with the reverse solicitation regime. Still, analysis pertaining to this distinction shall be utilised under Section No. 4. Retail clients, as per Article 4(1)(11) of MiFID II are persons which do not fall under the scope of professional clients. Professional clients, on the other hand, are outlined in great detail under Annex II of MiFID II,[32] which provides for an exhaustive list of entities deemed to be apt for exposures to larger risks when compared to retail clients. Should an entity adhere to the standards under Annex II, it will allow for the presumption that the client is indeed a professional entity.

As per Annex II of MiFID II, professional clients are entities which possess a substantial professional and educational background allowing them to make educated assessments of their investment choices,[33] in particular in relation to the inherent risk level for the respective investment type. Taking into account these characteristics, MiFID II presumes that such entities are well suited to opt for suitable investment choices and are able to make the right call when soliciting financial services and products.

The first four paragraphs of Annex II of MiFID II provide for an exhaustive list of entities which are presumed to be *per se* professional clients. These include, *inter alia*, such players of the financial market as credit institutions and institutional investors, as well as undertakings whose financial stability is of sufficient quality.[34] Thresholds in terms of the financial stability of would-be professional clients can be explained by the legislators' intent to ensure that merely persons that may well weather the toughest of financial crises are able to be treated as professional clients and thus be exposed to higher risk levels, albeit carrying higher potential returns.

Oddly enough, MiFID II additionally provides for the right of *per se* professional clients to be requested to be treated as mere retail clients, therefore allowing such clients to enjoy equal safeguards as those applicable to retail clients,[35] which, as indicated above, enjoy a great detail of investor protection measures. Nonetheless, MiFID II further stipulates that such differing modes of treatment depend on the professional client's own request,[36] and the particulars of such arrangement are to be further dealt with under an explicit agreement defining the scope and extent of such request.[37] However, once requested by the professional client, MiFID II does not provide for any other recourse than to afford additional protection measures. This re-categorisation regime is of importance for large undertakings, which do not operate in financial markets on a professional basis, and thus might not be able to determine a well-balanced investment path.

Similarly, client re-categorisation rules also permit retail clients to be treated as professional ones, provided their experience in financial dealings conform to certain criteria, their investment portfolio is of a sufficiently large size, or the respective client has a professional

[32] *Supra* note 9, Article 4(1)(10).
[33] Moloney, *supra* note 3, p.353.
[34] *Supra* note 9, Annex II.
[35] *Supra* note 9, Annex II.
[36] Moloney, *supra* note 3, p.354.
[37] *Supra* note 9, Annex II.

and thus also education backgrounds in the area of finance.[38] Much like with the transformation from *per se* professional to retail clients, the transition from retail to professional client classification regime is also to be initiated on the basis of an explicit written request from the retail client. The investment firm, subsequently, is obliged to highlight the particular risks the upcoming professional client would thereafter be exposed to.[39]

Particular attention ought to be paid to the ban imposed upon service providers granting incentives for retail clients to facilitate their requests to be treated as professional client. Moreover, MiFID II prohibits the incorporation of such requests under existing contracts concluded between the firm and the client, instead calling for the entry into a separate agreement.[40] First, such incentives on the part of the undertaking will inevitably violate the existing investor protection concerns, since firms are seen as possessing a significantly broader wealth of knowledge, and thus might well abuse the existing knowledge dissymmetry to incorrectly convince the retail client that being treated as a professional client would prove to be more beneficial to the client. Given the overall requirement for service providers to act in the interests of the client,[41] sufficient safeguards must be put in place to ensure compliance with this notion. Moreover, by imposing the requirement to have such request stated in a wholly separate and explicit document, MiFID II further ensures that these requests cannot be incorporated as a mere footnote within a broader agreement, which retail clients might well not notice and thus consequently become a professional client by accident.

As noted above, these restrictions additionally fall in line with the overall duty of financial service providers to act in the interests of their clients.[42] The concept, *inter alia*, provides for the need to ensure that clients, depending on their category, receive services best suited for them. The requirement to act in the interests of clients is particularly important when dealing with mere retail clients, which are deemed to lack a suitably high degree of competence vis-à-vis financial services and instruments, therefore bringing about the need of client categorisation. The concept thus provides that undertakings are to utilise the knowledge and competence of their personnel in a responsible, diligent and careful manner,[43] therefore avoiding situations of gross negligence or ill intent. Consequently, should the undertaking regard the retail client as lacking the needed level of expertise vis-à-vis the particular financial service or product, the firm must disregard the retail client's request to be treated as a professional client.

Moreover, the client re-categorisation rules do not permit a mere high-level examination on the part of the firm. A presumption that the particular retail client truly possesses the necessary level of competence purely on the grounds that the respective person meets any one of the professional client criterion cannot prevail over the financial firm's obligation to nonetheless undertake a diligent examination of the retail client's suitability.[44] Instead of

[38] *Supra* note 9, Annex II.
[39] *Supra* note 9, Annex II.
[40] International Capital Market Association. *ESMA Q&A Updates on MiFID II/R Data Reporting, Investor Protection and Intermediaries Topics*, p.4. Available on: https://www.icmagroup.org/assets/documents/Regulatory/MiFID-Review/Briefing-note---ESMA-QA-updates-on-MiFID-II-R-data-reporting-investor-protection-and-intermediaries-topics-25-May-2018-070618.pdf. Accessed 9 February 2019.
[41] *Supra* note 9, Recital 3.
[42] *Supra* note 9, Recital 71.
[43] International Capital Market Association, *supra* note 40.
[44] International Capital Market Association, *supra* note 40, p.5.

permitting a mere *prima facie* presumption that the retail client requesting to be treated as a professional client, firms are under the obligation to undertake an extensive assessment of the competencies of the particular client to ensure the client is capable of making calculated and risk-appropriate investment choices with little to no assistance from the undertaking.[45]

Consequently, even under scenarios wherein retail clients themselves certify that they adhere to standards applicable to professional clients, firms must still perform a thorough assessment. Even the slightest degree of doubt in assessing submissions of the retail client requesting to be treated as a professional client has been suggested as amounting to sufficient grounds to require further evidence gathering operations.[46] Whereas these in-depth examinations undoubtedly provide for additional bureaucratic barriers for financial service providers, the overall notion of investor protection rules prevail over the comparatively minor encumbrances borne by financial firms.

Given that particular investment services and products may be rendered to only professional clients, and given the above outlined procedure for retail clients to be dealt with as professional clients and vice-versa, financial service provides ought to beware of the distinctions as laid down by MiFID II. The above regime will become of great importance for non-EU entities operating within the Union’s markets on the basis of reverse solicitation, should MiFID II undergo a revision in accordance with section No. 6 of this work.

2.2. NOTION OF "OWN EXCLUSIVE INITIATIVE"

The phrase "own exclusive initiative" as used under Article 42 of MiFID II is of particularly uncertain nature. Whereas the legislator has not provided for a concrete definition of how exactly to interpret this concept, the phrase by and large prohibits third-country firms from advertising their services within the Union and thereafter rendering the respective services to clients from the EU. As outlined under the above section No. 2.1, such advertising and incentivising prohibitions are applied in relation to retail and professional clients alike. The suitability of the current non-differentiation approach, however, shall be addressed under subsequent chapters.

2.2.1. Marketing

Much for the detriment of third-country firms operating on the basis of reverse solicitation, neither Article 42, nor Recitals 85 and 111 of MiFID II list sufficient criteria as to what exactly the concept of marketing entails.

When considering the notion of "own exclusive initiative" in conjunction with Recital 85 of MiFID II, and marketing impediments under Article 42 of MiFID II, additional issues arise.[47] As per Recital 85, the respective client will be deemed to have approached the third-country investment firm and subsequently solicited its service on their own initiative, provided the client had not been influenced by "personalised communication"[48] containing either an invitation to conclude a contract, or aimed at persuading the client to enter into such relationship with the financial service provider.[49] It further stipulates that marketing activities

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[45] Moloney, *supra* note 3, p.354.
[46] International Capital Market Association, *supra* note 40, p.5.
[47] Nemeczek, *supra* note 27, p.461.
[48] *Supra* note 9, Recital 85.
[49] *Supra* note 9, Recital 85.

that are both "general and addressed to the public or a large group or category of clients"[50] will not amount to prohibited activities, and pursuing such actions will not impede the firm from utilising Article 42 of MiFID II. At a first glance, Recital 85 of MiFID II thus seems to negate the marketing restrictions on the basis of the "own exclusive initiative" concept.

In relation to the above, it is of importance to stress the use of particular words under Recital 85 of MiFID II. First, it renders "personalised communication" inaccessible for non-EU firms. Instead, undertakings are to rely on advertising materials of general nature in terms of both the target audience, and the contents of such marketing activities. Moreover, any such marketing material may not contain a direct invitation to treat. However, at the same time Recital 85 prohibits promotions which "may influence the client"[51]. Given the very goal of any marketing material, i.e. the attainment of additional clientele and the general promotion of a particular firm's services or products, Recital 85 appears to both allow and prohibit third-country service providers from undertaking marketing activities. Nonetheless, when read in conjunction with the latter part of Recital 85, marketing activities of general nature advertised to the general public, apparently, will not be seen as having the effect of influencing its target audience.

Additionally, Recital 85 not only covers marketing towards the public, but also "larger group or category of clients"[52]. In terms of "the public", European financial services law generally refers to an unlimited number of addressees. At the same time, groups of clients or categories of clients have been suggested to merely include no more than 150 advertising recipients. Notwithstanding, the concept has also been analysed in conjunction with an assessment of the underlying client-company relationship. Hence, for example, circumstances wherein more than one half of clients targeted by such marketing activities are not known to the service provider, i.e. there is no underlying relationship between the two persons, it should be seen as targeting "the public".[53] Whereas it is difficult to argue in support of either approach over the other, a mix of the two could well be incorporated in upcoming EU Directives, whereby both a minimum threshold of targets and the underlying past relationships would be of importance.

The use of "larger", however, adds an additional element to the marketing restriction, as groups or categories of just 150 advertising recipients might well be deemed to fall short of the notion of "larger groups". MiFID II does not, however, provide for any further guidance in relation to Recital 85. Moreover, client categorisation is of essence also for the interpretation of "own exclusive initiative", since Recital 85 of MiFID II permits general marketing activities towards "a larger … category of clients"[54] without yet again differentiating between retail and professional clients.

Last, but not least, these advertising activities are permitted only insofar as they are *per se* general. It consequently follows that MiFID II imposes an obligation of sorts requiring such marketing activities to be obviously general without requiring any further review or analysis. Should the third-country entity have to resort to an in-depth analysis to prove its marketing

[50] *Supra* note 9, Recital 85.
[51] *Supra* note 9, Recital 85.
[52] *Supra* note 9, Recital 85.
[53] Markus Pfüller and Rainer Schmitt, "Erster Abschnitt: Vorschriften über den Vertrieb ausländischer Investmentanteile *[First chapter: Rules on the Distribution of Foreign Investment Units]*," in *Gesetz über Kapitalanlagegesellschaften, Auslandsinvestment-Gesetz [Law on Investment Companies, Foreign Investment Law]*, ed. Brinkhaus and Scherer (Munich: Verlag C.H. Beck München, 2003): p.1335.
[54] *Supra* note 9, Recital 85.

activities are, indeed, "by their very nature general"[55], this aspect will not have been abided by and the firm would be found to have exceeded the scope of Recital 85.

However, as suggested by scholarly writing, the scope of Recital 85 is very much different from Article 42 of MiFID II. Instead of referring specifically to third-country firms, Recital 85 of MiFID II only uses the term "firms". Consequently, it could be argued that Recital 85 is not a mistake, and instead refers to marketing activities undertaken by European financial services providers.[56] Nonetheless, such interpretation is not entirely consistent with the rest of MiFID II, for reverse solicitation is only utilised in relation to Article 42 of MiFID II. The scope of Article 42, as previously described, however, is restricted to third-country entities, therefore expressly excluding intra-EU entities aiming for a pan-European distribution network without using some other arrangement, say, their European "passports".

The wording of Recital 85 specifies the provision of services "at the initiative of a client"[57], causing only further confusion. The aforesaid phrase is used only once throughout MiFID II, namely, it has only been incorporated under Recital 85 itself. Nowhere else throughout the text of MiFID II is this concept utilised. However, it does appear to be strikingly similar to the concept of "own exclusive initiative" as provided for under Article 42. Consequently, Recital 85 increasingly appears to be a mere afterthought inserted into the text of MiFID II at the very last minute. Nonetheless, in analysis MiFID II, and paying particular attention to the overall spirit and more specifically the wording of Article 42, Recital 85 appears to be intended to be applied in relation to non-EU entities. On the basis of the aforementioned, it is hereby submitted that Recital 85 is not to be read as referring to European entities, and must instead be interpreted as covering the marketing and promotional activities of non-EU firms. Consequently, marketing restrictions stemming from Article 42 of MiFID II are at least partially nullified in terms of general promotional activities absent references to particular services and products offered by the respective third-country firm.

Notwithstanding the means via which marketing and promotional material is disseminated, i.e. by the third-country firm itself or any person acting on the behalf or in the interests of the undertaking, marketing will be deemed to have taken place. Moreover, it is of no importance whether the firm or its intermediaries execute promotional activities in the presence of the client, over the phone or via internet advertising material published within the EU.[58] Thus, ESMA views the term "marketing" as encompassing the widest possible array of activities with no regard to the particular circumstances of the client-firm encounter.

In light of the apparent chaos caused by the interplay of Article 42, Recital 111, and Recital 85 of MiFID II, the importance of issues pertaining to marketing activities is only further amplified. With seemingly contrary permitted marketing regimes incorporated within the same exact legal document, MiFID II appears to barely shed any light upon the issue. Be that as it may, in view of the author recent scholarly discourse provides for an interpretation that is not entirely aligned with the overall nature of MiFID II.

[55] *Supra* note 9, Recital 85.
[56] Nemeczek, *supra* note 27, pp.461-462.
[57] *Supra* note 9, Recital 85.
[58] European Securities and Markets Authority. *Questions and Answers on MiFID II and MiFIR Investor Protection and Intermediaries Topics: 3 October 2018*, p.104. Available on: https://www.esma.europa.eu/file/23414/download?token=dySuQzDC. Accessed 20 April 2019, p.96.

2.2.2. Temporal effect of marketing restrictions

MiFID II also causes only further chaos by failing to define the temporal effect of the marketing, promotion and solicitation ban. One could well argue that Article 42 of MiFID II should be read as covering advertising activities of third-country entities only following the entry into force and subsequent application date of MiFID II. This is further confirmed by the interpretation of "new categories of investment products or investment services"[59] as analysed under section No. 2.2 of this thesis, whereby the prohibition to offer supplementary services applies from 3 January 2018 onwards only.[60] Should that not be the case, non-EU firms face the potential threat of being barred from ever accessing the EU market on the basis of reverse solicitation purely because of marketing activities that had taken place decades ago. Such interpretation would subsequently give rise to questions pertaining to concepts of proportionality and suitability, which, in the view of the author, would not have been adhered to.

However, MiFID II only goes as far as to stipulate that prior marketing and promotional activities within the EU will prevent third-country firms from relying on the concept of reverse solicitation.[61] One ought to note that MiFID II refers to marketing and promoting of "investment services or activities"[62] as opposed to specifying the scope of such activities only to the financial services provided to the respective EU-based client. Thus, MiFID II imposes an overall and general ban on third-country firm advertising within the Union,[63] preventing the use of reverse solicitation even in cases where the non-EU firm advertised, say, the provision of investment advice, whereas the client approaching the firm requests portfolio management services or other wholly separate financial service or product. The extent of this limitation, however, is somewhat curtailed by taking into account Recital 85 of MiFID II.

Even though in the above-mentioned example the advertised service is an entirely different financial service from the one actually requested by the client, MiFID II does not regard such distinction as sufficient grounds to permit the use of reverse solicitation. Thus, following MiFID II, no advertising activities of third-country undertakings, even ones merely referencing financial services provided by the firm, may be undertaken within the EU.

2.2.3. Marketing towards retail and professional clients

As described under chapter No. 2.1 relating to service and product recipient categories, MiFID II does not differentiate between marketing restrictions in relation to retail and professional clients. Therefore, non-EU entities are subject to equally restrictive promotional regimes when interacting with either retail or professional entities. Notwithstanding, it has been argued that generic firm advertising material can be disseminated throughout the Union with little concern,[64] provided they do not refer to particular services and products offered by the firm. Thus view is only further bolstered by taking into account the above review of Recital 85 of MiFID II, which further clarifies the otherwise hazy line between permitted and prohibited marketing activities.

[59] *Supra* note 9, Article 42.
[60] European Securities and Markets Authority, *supra* note 58, p.97.
[61] *Supra* note 9, Recital 111.
[62] *Supra* note 9, Recital 111.
[63] Busch, *supra* note 17, paras.10.75-10.77.
[64] Nemeczek, *supra* note 27, p.461.

In addition, taking into account the further distinction in relation to "new categories of investment products or investment services"[65], which prohibits the firm from offering additional services not requested by the client on their "own exclusive initiative", such marketing activities may not be directed towards the client even in the performance of the original service requested by the client. In terms of marketing, the current MiFID II regime is at odds with the presumption that activities rendered under reverse solicitation are not deemed to have been performed within the territory of the EU. Namely, Recital 111 leads to the apparently false presumption that promotional activities directed at the client within the existing relationship between the client and the third-country entity would also be seen as having been provided outside the EU. This separation therefore creates a distinction between marketing towards potential would-be clients of the third-country service provider, and promotion of additional services within the wider framework of the existing client-firm relationship once the provision of services has already been initiated by the client on their "own exclusive initiative".

2.3. PROVISION OF "NEW CATEGORIES OF INVESTMENT PRODUCTS OR INVESTMENT SERVICES"

As per Article 42 of MiFID II, reverse solicitation does not extend to the provision or marketing of "new categories of investment products or investment services to that client"[66] within the scope of the existing client-firm relationship based on reverse solicitation. The different investment service categories are laid out under Annex I of MiFID II, which differentiates between and sets forth core and ancillary services.[67] Notwithstanding the separation between product and service classes under MiFID II, this aspect is of no relevance for non-EU service providers.

Considering the aforementioned restriction, it becomes clear that the "own exclusive initiative" of the client is to be assessed on every single instance when performing a transaction. At the same time, it is not necessarily clear whether the same service once already solicited by the service recipient according to the MiFID II regime under Article 42,[68] since the Directive neither confirms, nor outright bans such activities. Whereas theoretically permissible, the continued performance of the same exact service may still run contrary to the requirement for the client to have solicited the service on their own. Moreover, it is likely to draw closer regulatory scrutiny,[69] given the overarching marketing restrictions and the likelihood of varying perceptions in terms of the concept of marketing.

Contrary to claims calling for the extension of Article 42 of MiFID II in relation to new services and products offered to clients on the basis of a relationship once already legitimately established,[70] say, wherein the client approaches the third-country firm on their own exclusive initiative, and the non-EU entity subsequently offers additional services, such approach would obviously violate the MiFID II regime. Nonetheless, as argued elsewhere throughout the

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[65] *Supra* note 9, Article 42.
[66] *Supra* note 9, Article 42.
[67] *Supra* note 9, Annex I.
[68] Peter Snowdon, Hannah Meakin and Simon Lovegrove, "MiFID II/MiFIR," *Compliance Officer Bulletin* 116(2014): p.31. Available on: Thomson Reuters Westlaw. Accessed 2 May 2019.
[69] *Ibid*, p.32.
[70] Barnabas Reynolds and Thomas Denegan, "Continuity of Contracts and Business on a "Hard" Brexit: Human Rights and Reverse Solicitation to the Rescue!" *Journal of International Banking Law and Regulation* 2018: p.83. Available on: Thomson Reuters Westlaw. Accessed 2 May 2019.

thesis, such approach might not necessarily be of detriment when applied in relation to *per se* professional clients only.

Crucially, however, guidance issued by ESMA affirms the temporal effect of the prohibition in relation to promotion of additional services. By considering that the ban only applies to services and products rendered following the application of MiFID II,[71] ESMA confirmed that past conduct by non-EU entities may not inhibit their ability to fully utilise Article 42 of MiFID II. This analysis can subsequently also be applied to the marketing restriction, thus establishing that marketing activities performed within the EU prior to MIFID II would not bar third-country service providers from relying on the reverse solicitation regime.

At the same time, however, ESMA regards the provision of different services following 3 January 2018 than those rendered prior to the date as a prohibited activity.[72] Consequently, in considering the ban on promoting additional product and service categories, should a retail or professional client, approach a third-country firm with a request to provide, say, portfolio management services, the respective undertaking may not permit the provision of additional services or offer the client to provide further activities. The aforesaid example presumes the above-described restrictions in terms of activities prohibited under reverse solicitation have been abided by. The first prohibition would consequently breach the ban in relation to "new categories of investment products or investment services"[73]. The second restriction in the promotion of further services by the firm to the client, as outlined under section No. 2.3 of this work, would run counter to the prohibition to market services to EU clients.

In considering whether additional services have been promoted towards an EU-based client, ESMA yet again foresees an in-depth examination on a case-by-case basis. First, such analysis would subsequently provide for an assessment as to the type of service or product being offered within the scope of the existing transaction. Second, the nature of the service or product would have to be assessed, taking into account the inherent risk level and complexity of the products.[74] Third-country firms must clearly differentiate between the various product classes and categories on the basis of the above criteria to reduce the possibility of regulatory arbitrage and misuse of Article 42 of MiFID II in undermining EU law regulations.

However, once a particular client has approached the firms on their "own exclusive initiative" for the provision of a particular service, the non-EU entity is entitled to market towards that particular client services and products of similar enough nature. As pointed out above, the particular comparison between services and products once already provided, and those subsequently offered within the boundaries of the already-existing relationship is to be performed time and time again when assessing different circumstances. Nonetheless, ESMA has provided for some much-needed guidance in this regard by setting the scope of services and products belonging to different categories, stipulating that "a subordinated bond does not belong to the same category as a plain-vanilla debt instrument"[75]. While this comment might be based on a scenario wherein the differences are quite obvious, ESMA has refrained from sharing its interpretation of circumstances that would not be quite as obvious.

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[71] European Securities and Markets Authority, *supra* note 11, p.104.
[72] European Securities and Markets Authority, *supra* note 11, p.104.
[73] *Supra* note 9, Article 42.
[74] European Securities and Markets Authority, *supra* note 58, p.97.
[75] European Securities and Markets Authority, *supra* note 11, p.104.

2.4. EFFECT OF THE CURRENT REVERSE SOLICITATION REGIME

As provided by the previous subchapters, reverse solicitation under the current Article 42 of MiFID II allows non-EU financial service providers to enter into transactions with Union-based clients without facing any regulatory entry hurdles. However, the regime in its present iteration consists of a total of five distinct components third-country entities must first take into account.

First and foremost, non-EU firms need not differentiate between the two client categories, as reverse solicitation may be utilised when dealing with both retail and professional clients. Similarly, the reverse solicitation concept does not impose any further limitations in terms of *per se* professional clients, at-request retail, and at-request professional clients. Thus, whenever European clients solicit financial services on their own exclusive initiate, third-country firms need not carry out any examination in this regard.

Nonetheless, the aforesaid requirement for the client to have solicited the particular service or product "on their own initiative" carries a great deal of limitations stemming from the MiFID II marketing regime. First and foremost, MiFID II appears to generate a blanket ban on any sort of client solicitation, marketing or other promotional activities within the Union as undertaken by the third-country firm. However, following an analysis of Recital 85 of MiFID II, the Directive appears to have provided for sufficient legal basis for non-EU undertakings to engage in promotional activities of highly general nature without incorporating concrete offers or other incentives for European clients to enter into contracts with the respective firm.

Additionally, the "own exclusive initiative" aspect further seems to bar the service provider from offering the European client to enter into yet another contract for the provision of a service wholly different from the one originally solicited by the client pursuant to the Article 42 regime. Nonetheless, one could still argue for the possibility to still offer the repeated provision of the same exact service originally sought after by the Union-based client.

As follows from the above considerations, Article 42 of MiFID II provides for a seemingly unfettered framework for access to European clients. However, the exceptionally vague use of language in setting up the scope of the most important aspects forming the reverse solicitation regime evidently is a major shortcoming of the Directive. In absence of any concrete EU-wide regulatory guidance providing interpretation of any one of the aforesaid considerations, third-country financial service providers get to enjoy an exceptionally meagre level of legal certainty. In turn, failure to ensure a sufficient degree of legal certainty renders the reverse solicitation regime under MiFID II far too risky for entities licenced under non-EU jurisdictions. Consequently, even those few third-country firms choosing to operate on the basis of reverse solicitation would still face immense regulatory risks due to differences in national member state regulatory authorities' interpretations of each one of the five concepts.

3. REVERSE SOLICITATION UNDER AIFMD

Much like with financial services and products under MiFID II, alternative investment funds, governed by the AIFMD, underwent significant changes following the 2008 financial meltdown. In efforts to mitigate the negative consequences of future financial markets' disasters, AIFMD imposes certain restrictions in relation to alternative investment fund managers (hereinafter: AIFMs), i.e., persons who manage alternative investment funds (hereinafter: AIFs).[76] AIFs, on the other hand, are undertakings for collective investment, which simultaneously "raise capital from a number of investors, with a view to investing it"[77], and simultaneously are not covered by Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities[78] (hereinafter: UCITS).[79] In essence, the scope of AIFMD is limited to funds investing in a wide variety of targets not covered under the UCITS directive.[80] The UCITS regime, however, does not envision an equally liberal approach in terms of third-country service providers intending to render services within the EU,[81] and thus shall not be addressed under this work.

For the purposes of the AIFMD, marketing as per Article 4(1)(x) of AIFMD is deemed to amount to the "offering or placement … of units … of an AIF"[82]. Whereas there is no such explicit equivalent of Article 42 MiFID II incorporated under the AIFMD, the notion of reverse solicitation stems from the definition of marketing. Namely, non-EU AIFMs managing AIFs too are entitled to allow European clients to invest into AIFs under their control provided the client approached them on their own initiative.[83] It is yet again of importance to highlight the difference between reverse solicitation under MiFID II and AIFMD, wherein the former provides for an explicit right for third-country service providers to utilise the reverse solicitation regime, whereas reverse solicitation is only implied under the latter Directive.[84] Notwithstanding this difference, the two reverse solicitation regimes are still inherently one and the same. Thus, whereas AIFMD only relates to a particular set of undertakings dealing with a highly specific set of financial instruments and mechanisms, reverse solicitation under AIFMD is based on the same cornerstone principles and thus remain relevant for the interpretation of Article 42 of MiFID II.

Similarly to MiFID II, AIFMD remains silent when it comes to providing a more concrete explanation as to under what scenarios would a non-EU AIFM still be able to rely on reverse solicitation, i.e., under what circumstances a particular intra-EU client will be seen as having

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[76] Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.
[77] *Ibid*., Article 4(1)(a).
[78] Directive 2009/65/EC of the European Parliament and of the Council of 13 July 2009 on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities.
[79] Bentley, *supra* note 2, pp.42-43.
[80] European Securities and Markets Authority. *Report on Trends, Risks and Vulnerabilities*, pp.47-78. Available on: https://www.esma.europa.eu/sites/default/files/library/esma50-report_on_trends_risks_and_vulnerabilities_no1_2019.pdf. Accessed 4 April 2019.
[81] Moloney, *supra* note 3, p.307.
[82] *Supra* note 76, Article 4(1)(x).
[83] Bentley, *supra* note 2, pp.47-48.
[84] Dr. Akexandros L. Seretakis, "Brexit and Alternative Investment Fund Managers," *Journal of International Banking Law and Regulation* 2019: p.143. Available on: HeinOnline. Accessed 15 May 2019.

approached the AIFM at their own discretion. As has been suggested in scholarly writing, the fine line between reverse solicitation and prior marketing activities breaching AIFMD is particularly tricky, even more so considering that the potential negative consequences include civil, administrative and even at times criminal liability, depending on the particular jurisdiction.[85] Moreover, such breach on part of the AIFM might well give rise to the client having a claim against the AIFM for inefficient managing of the fund in relation to the breach of AIFMD.[86] Considering both the implied nature of reverse solicitation under the AIFMD, and the heavy-handed sanctions for breaches, AIFMD provides for a worse regulatory regime when compared to that stemming from MiFID II.

3.1. NOTION OF "MARKETING" UNDER AIFMD

Given that reverse solicitation is not explicitly defined under the AIFMD, and instead it follows from a closer interpretation of the notion of marketing under the directive, national laws transposing the AIFMD might well provide for an entirely different view.[87, 88] In this regard, Article 42 of MiFID II provides for a significantly higher degree of harmonisation, as reverse solicitation is not an implied approach reserved for non-EU entities. On the one hand, it affords third-country firms a greater degree of legal certainty when providing services to European clients. On the other hand, firms are likely to be seen as legitimate actors lawfully accessing EU clients, instead of having to rely on regulatory arbitrage and its exploitative nature.

When assessing reverse solicitation under AIFMD, as expressed further under sections of this thesis, AIFMD does not expressly provide for an equivalent regime to that incorporated under Article 42 of MiFID II. Instead, the possibility for non-EU entities to utilise reverse solicitation depends upon the various national laws transposing the AIFMD into the respective local regulatory framework.[89] National transposition, however, might well incorrectly define the notion of marketing, and fail to allow for reverse solicitation in the respective jurisdiction.[90] The national transposition mechanism can additionally introduce further requirements or restrictions via the so-call "gold-plating" approach,[91] whereby new measures not provided for by the AIFMD are brought about by national legislators. Even in absence of "gold-plating", seemingly trivial new measures introduced by EU member states result in substantial compliance issues for financial undertakings operating across the European market.[92] The following shall provide a brief review of the national frameworks in force in the United Kingdom (hereinafter: UK), Germany, and France, the three largest European economies which subsequently have the most active financial markets.

When assessing the particular laws of the UK, the notion of marketing activities becomes easily definable. The approach of UK's regulatory authority, the Financial Conduct Authority

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[85] Bentley, *supra* note 2, p.49.
[86] *Ibid*.
[87] Stephen G. Sims, Patrick Brandt, Daniel F. Faundez, "The Future of Marketing Non-EU Alternative Investment Funds in Europe," *The Banking Law Journal* 131(2014): p.279. Available on: HeinOnline. Accessed 16 February 2019.
[88] Bentley, *supra* note 2, p.49.
[89] Bentley, *supra* note 2, pp. 47-48.
[90] Sims, *supra* note 87, p.279.
[91] Gianna Sagan, "Alternative Investment Fund Managers Directive Impact on Non-EU Managers," *Review of Banking & Financial Law* 506(2015): p.510. Available on: HeinOnline. Accessed 16 February 2019.
[92] *Ibid*.

(hereinafter: FCA) is hereby submitted as solid example in terms of approaching reverse solicitation under the AIFMD. In view of the FCA, for one, marketing of AIF units amounts to "making a unit of share of an AIF available for purchase"[93].[94] Moreover, the mere offering of such possibility to acquire extended towards a potential client, and an invitation to conclude a contract will equally trigger the licencing requirement.[95, 96] Notwithstanding this peculiarity, the current AIFM framework in the UK is limited to marketing activities aimed at the particular AIF.[97] If the AIFM where to market a wholly separate AIFM, as per the letter of the law, the third-country AIFM could well continue to rely on the reverse solicitation exemption.[98] Additionally, general marketing activities are thus deemed to fall outside the scope of AIFMD restrictions.

Moreover, the use of the "making … available for purchase"[99] aspect must be placed under closer scrutiny. As has been suggested by scholars, insofar as potential EU-based clients are informed about the AIF under the management of the non-EU AIFM without offering the client to purchase them, this strategy would thus not amount to marketing activities, and should instead be seen as "pre-marketing".[100, 101] As opposed to straightforward marketing, pre-marketing is not covered by either AIFMD or MiFID II, and thus are currently prohibited under neither directive. MiFID II imposes restrictions in terms of soliciting, marketing and promotional activities directed towards European clients, but does not refer to similar activities falling short of marketing. Given that the AIFMD too provides for similar treatment of third-country entities providing services within the EU, the insights stemming from the AIFMD might come in handy when determining the scope of MiFID II restrictions. However, it could well be argued that pre-marketing activities are by and large identical to promotion under Recital 85 of MiFID II, i.e. activities inherently general and not targeting individual clients.[102]

Nevertheless, the FCA's opinion as regards publicly available data is particularly odd in the age of digitalisation. As per the FCA, applications or other material needed for the conclusion of an agreement accessed on an open website of an AIFM by a client who thereafter decides in favour of entering into a transaction with the AIFM, would violate the reverse solicitation method.[103] This, in turn, requires potential service providers to conceal parts of their public websites from site visitors domiciled in the UK.[104] Should this interpretation be scrutinised, one must first take into account that offers for purchase are banned by default. Consequently, by presenting concrete agreements to the client enabling the entry into a transaction, the

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[93] Financial Conduct Authority. The Perimeter Guidance Manual, paras. 8.37.5-8.37.6. Available on: https://www.handbook.fca.org.uk/handbook/PERG.pdf. Accessed 23 April 2019.
[94] Bentley, *supra* note 2, p.48.
[95] Marco Bodellini, "The European Union Regulation on Marketing of Alternative Investment Funds: Another Step towards Integration of the European Union Financial Market," *Business Law Review* 37(2016): p.212.
[96] Bentley, *supra* note 2, pp.47-48.
[97] Marco Bodellini, "The Marketing of Hedge Funds in the United Kingdom: Did the System Maintain Its Attractiveness after the Transposition of the Alternative Investment Fund Managers Directive?" *Business Law Review* 37(2016): p.167.
[98] Clive Cunningham, Pat Horton and Nish Dissanayake, "Marketing Challenges" *International Financial Law Review* (2013): p.78.
[99] Financial Conduct Authority, *supra* note 93.
[100] Bentley, *supra* note 2, pp.49-50.
[101] Stephanie Loizou, "Pre-Marketing under the AIFMD", *Journal of International Banking Law and Regulation* (2018): p. 246.
[102] *Supra* note 9, Recital 85.
[103] Cunningham, *supra* note 98, p.79.
[104] *Ibid*.

AIFM would violate the scope of pre-marketing. As clearly indicated under preceding paragraphs, this must not, however, be interpreted as some overall ban on general marketing which does not incorporate an offer to acquire AIF units.

German law, however, provides for a broader interpretation of activities amounting to "marketing", for it covers both concrete offers to conclude a contract directed at the specific client, and general marketing activities.[105] By referring not only to invitations to enter into contracts and even marketing in general, non-EU AIFMs find themselves even more constrained. Without differentiating between the various methods a third-country entity might market its activities towards clients residing in Germany, be it solicitation in person, over the phone or via electronic means, including advertising materials on publicly accessible websites, Germany aims to prohibit activities with the aim of influencing the client into purchasing the provider's services or products. As restrictive as it may be, it has ensured applicability and relevance over the years, having withstood technological developments granting service providers additional channels to reach potential clients.[106] However, this interpretation of marketing should not necessarily be extended to MiFID II, given that its Recital 85, at least in theory, provides for a wide array of exemptions.

Going even beyond the approach of German regulators, France has defined marketing in even broader terms, stipulating that it includes "presenting them on French territory … with a view to encouraging an investor to subscribe for or purchase"[107] units in the AIF.[108] Whereas it comes short of specifying the particular documentation which would permit non-European AIFMs to rely on reverse solicitation,[109] the geographical scope of the marketing ban of importance for reverse solicitation is of immense assistance. Consequently, marketing activities outside the territory of France, even if targeting specifically French nationals, are not banned by French supervisory authorities.

Time and time again have scholars underlined the need to acquire and ensure the proper maintenance of documentation from the client confirming the use of reverse solicitation under the AIFMD.[110] However, at the same time, national peculiarities have to be taken into account, as not all European jurisdictions will permit written confirmations from the third-country firms' clients as sufficient basis to establish that the client did indeed solicit the respective services on their own exclusive initiative.[111] Furthermore, such additional recordkeeping burden would only add on to the other administrative considerations to be abided by service providers.

Similarly, it remains questionable whether the confirmation model would adhere to the standards set forth by MiFID II. As described above, in terms of the existing client re-categorisation regime, firms are under the obligation to closely scrutinise the particular retail client's suitability to be treated as a professional client. Given the inability for service providers to rely on their clients' own submissions, it could well be submitted that a simple

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[105] Derleder, *supra* note 15, p.766.
[106] Brinkhaus, *supra* note 53, pp.1334-1335.
[107] Autorité des marchés financiers. Guide to UCITS, AIF and Other Investment Fund Marketing Regimes in France, p.3. Available on: https://www.amf-france.org/technique/multimedia?docId=workspace://SpacesStore/e06aba86-fb44-4083-b597-4c729b6464d8_en_5.0_rendition. Accessed 30 April 2019.
[108] Bentley, *supra* note 2, p.50.
[109] *Ibid*.
[110] Seretakis, *supra* note 84, p.144.
[111] Bentley, *supra* note 2, p.56.

confirmation from the client might fall short of establishing reverse solicitation. At the same time, it is difficult to imagine what type of documentation exactly would suffice to confirm that the client approached the firm on their "own exclusive initiative". Consequently, the reliance on client confirmations, coupled with the firms' adherence to marketing rules remains the sole possibility to establish conformity with MiFID II. However, confirmations from service recipients, as detailed in the following paragraphs, have their own shortcomings.

Despite claims that mere confirmations from European clients investing into AIFs affirming their investments have been made on the basis of reverse solicitation would suffice to permit the AIFM to rely on this concept,[112] this remains a particularly risky proposition to rely upon. Given the different treatment afforded depending on the particular member state in question, third-country AIFMs ought to exercise immense caution under the AIFMD. This aspect only further increases in importance considering that one of the EU's current main financial centres, the UK, permits reverse solicitation insofar as the non-EU AIFM has obtained from the EU-based client the above mentioned confirmation before the provision of services. Provided such affirmation has been obtained prior to the transaction, and clearly refers to both the particular AIF and AIFM, the FCA regards it as sufficient basis to permit the execution of the transaction on the basis of reverse solicitation.[113] Nonetheless, in absence of full pan-European harmonisation, the reverse solicitation regime still must account for national peculiarities.

Additionally, as outlined above, it remains questionable how extensively such confirmations from EU clients could work under MiFID II. When comparing this aspect with, for example, the extensive due diligence process to be undertaken in case a retail clients wishes to be treated as a professional client on the basis of a separate request, it is doubtful that such confirmations from service recipients would meet the high bar of standards stemming from MiFID II.

Further uncertainty is caused by doubts whether such mere affirmation from the client reflects the true circumstances of the particular client-firm relationship and whether such confirmation is in line with the investor protection concerns. Moreover, as described under the above chapter covering MiFID II, these and similar claims as submitted by clients must not be accepted at face value. Instead, financial service providers maintain the obligation to approach such requests with due diligence and ascertain with a sufficient degree of certainty the validity of such claims.

This argument is further substantiated by the position of ESMA itself, for it has expressly dissuaded third-country firms from relying on documentation signed by the client affirming that they approached the service provider on their "own exclusive initiative".[114] Unfortunately, it has yet to clarify the proper way to demonstrate compliance with Article 42 of MiFID II, instead providing for a separate analysis in reference to each single service rendered to the client.[115] ESMA has, however, explained that "reverse solicitation should not be assumed"[116], thus effectively deferring any arguments calling for an assumption that the client acted on their "own exclusive initiative" in approaching the firm. Other than requiring

[112] Bentley, *supra* note 2, p.49.
[113] *Ibid*.
[114] European Securities and Markets Authority, *supra* note 58, p.96.
[115] *Ibid*.
[116] European Securities and Markets Authority, *supra* note 58, p.97.

the keeping of internal documentation substantiating the basis of client-firm relations,[117] it is currently difficult to devise a bulletproof method of proving the initiative of the client.

As highlighted by the uneven set of national restrictions, reverse solicitation for non-EU AIFMs is not a viable option for permanent operations. Where a number of national regulators have not provided for any sort of clarifications, other authorities regard the notion of "marketing" as encompassing a worryingly broad spectrum of activities. Consequently, the failure of AIFMD to harmonise the reverse solicitation regime means that non-European service providers would be exposed to far too many potential non-compliance risks.[118]

Interestingly enough, the AIFMD under Recital 92 calls for further harmonisation in terms of the client assessment procedure even when considering the potential acquisition of AIF units by *per se* professional investors on the basis of reverse solicitation.[119] Given how closely AIFMD and MiFID II are interlinked in terms of reverse solicitation, a revision MiFID II might well mirror that of AIFMD. This is particularly important in relation to the particular clause under AIFMD permitting reverse solicitation, as ensuring that it is no longer a mere "gap" in the law, and instead providing for an explicit definition, would afford a necessary degree of certainty for third-country entities operating on the basis thereof.

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[117] *Ibid*.
[118] Bentley, *supra* note 2, pp.50-51.
[119] Claude Kremer and Isabelle Lebbe, *Collective Investment Schemes in Luxembourg: Law and Practice* (Oxford: Oxford University Press, 2014), pp.495-496.

4. INVESTOR PROTECTION CONCERNS

As discussed above, MiFID II does not differentiate between retail and professional clients being serviced under reverse solicitation when laying down the aforesaid restrictions. However, the imposition of equally strict limitations for professional clients lacks a concrete legal basis. As per Annex II of MiFID II, *per se* professional clients need to adhere to a number of thresholds in terms of capital adequacy and personnel competence. Therefore, professional clients are well suited to be exposed to additional risks and must be granted a higher degree of freedom when soliciting financial services and products. Nonetheless, the current wording of Article 42 of MiFID II fails to provide for an appropriate set of restrictions applicable to third-country firms when engaging with professional clients.

By and large, investor protection concerns are based on the clients' trust into the system.[120, 121] Over time, the number of financial products available to retail clients, not to mention professional clients, has seen an immense expansion. However, alongside the positive growth in terms of services on offer, the risk level has also seen an increase.[122] New products have their own particular inherent risks which retail investors might not have necessarily faced before, and thus failure to protect retail investors in terms of liquidity shortages might result in an increase in the overall systematic risk framework.[123] Furthermore, this aspect becomes ever more important considering that services provided under Article 42 of MiFID II will be seen as having been executed in territories outside the Union. Therefore, the respective law of the third-country will become applicable, causing only further headache to retail investors.[124]

4.1. RESTRICTIONS IN RELATION TO RETAIL CLIENTS

Retail client protection mechanisms, on the one hand, aim to ensure a safe financial market for clients which do not possess immense assets to protect them from liquidity and solvency concerns in times of financial instability.[125] At the same time, the regulatory regime as of recently additionally aims to supplement the long-term financial stability of retail investors,[126] intending to improve the ability of non-professionals to build and safeguard their wealth. As opposed to professional entities, retail clients lack both the professional and academic background to properly assess the suitability of the particular investment service or product sought, and thus are unable to adopt the most optimum investment route.

Moreover, retail clients access the financial markets through much different channels when compared to those utilised by professional clients. Retail recipients must rely on the guidance of intermediaries, be it their credit institution or a separate investment advisor.[127] The use of such entities thus also subjects retail clients to obvious conflict-of-interest scenarios, wherein

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120 Niamh Moloney, "Investor Protection and the Treaty" in *Capital Markets in the Age of the Euro: Cross-Border Transactions, Listed Companies and Regulation*, ed. Guido Ferrarini, Klaus J. Hopt and Eddy Wymeersch (New York: Kluwer Law International, 2002), p.22.

121 Elias Bischof and Dr. Peter Jung, "Finanzdienstleistungsrecht *[Financial Services Law]*" in *Europarecht: Handbuch für die deutsche Rechtspraxis [European Law: Handbook for the German Legal Practice]*, ed. Dr. Reiner Schulze, Dr. Manfred Zuleeg and Dr. Stefan Kadelbach (Baden-Baden: Nomos Verlagsgesellschaft, 2015), p.1024.

122 *Supra* note 9, Recital 3.

123 Moloney, *supra* note 120, pp.19-23.

124 *Ibid*, pp.20-21.

125 Moloney, *supra* note 3, pp.806-807.

126 *Ibid*, p.770.

127 *Supra* note 9, Recital 70.

intermediaries are aiming to maximise their commissions, incentives and other financial perks,[128] often at the expense of the client.[129] Combined with the increasingly complex nature of financial services and products, retail clients are increasingly unable to comprehend the slight variations between services offered to them, much to their own detriment. Consequently, in absence of retail client protection rules,[130] intermediaries seeking to exploit their retail clients' lack of competence would thrive.

Considering the aforementioned, MiFID II provides for the issuance of tailor-made financial services, adjusted on the basis of the "personal needs, characteristics and objectives"[131]. Failure to abide by these standards will lead to the determination that the service provider has failed to act in the interests of the respective client, and thus breach the firm's obligations towards the service or product recipient.

On the one hand, retail and professional clients alike need to be afforded sufficient protection against operational failures on the part of the service provider. In absence of sufficiently robust regulation, clients may well see the assets they have invested disappear upon the winding-up of the service provider. At the same time, retail clients specifically are prone to suffer from predatory behaviour by financial undertakings. Thus, European markets need a mix of rules in terms of both prudential and systematic risks, with the former category catering for investor protection, whereas the second looking out for the financial stability of undertakings rendering the services.[132]

Retail clients are by far most exposed to prudential issues, as they are unable to either appropriately judge the present risks of the firm’s services, or simply do not fully comprehend the severity of problems facing them. This is explained by the combination of the information imbalance issue, and the peculiar fiduciary relationship, whereby the firm must suppress its appetite for immense returns in light of certain risks.[133] Not only do service providers possess a substantially broader wealth of knowledge in terms of the service to be rendered, investors themselves may be unaware as to what steps are to be taken to mitigate,[134] if not fully prevent, whatever risks they are exposed to.

In light of the achievement of the EU in attempts to safeguard retail investors, one may well benefit from taking a step back to assess whether a sufficient level has not already been reached, and whether further legislative action has the potential of inadvertently marching into an overly-regulated landscape.[135] For one, retail clients must not be absolutely protected from any and all risks, as otherwise one might well call for the complete erasure of even the tiniest risk levels in financial services. This, consequently, is more than likely to be the driving force behind the further increase in purely vanilla services lacking any sort of innovation.[136] In resolving this multi-dimensional issue, regard must still be had to the relative ineptness of retail investors, and it is not necessarily the case that retail investors should be pushed towards

[128] Moloney, *supra* note 3, p.771.
[129] Snowdon, *supra* note 68, p.20.
[130] Moloney, *supra* note 3, p.771.
[131] *Supra* note 9, Recital 71.
[132] Charles Goodhart, *Financial Regulation: Why, How and Where Now?* (London: Routledge, 1998), pp.4-5.
[133] *Ibid*, pp.5-6.
[134] Moloney, *supra* note 120, pp.23-25.
[135] Zak de Mariveles and Guillaume Eliet, "Is the current level of regulation aimed at protecting EU retail investors appropriate and effective?" *International Financial Law Review*, p.14. Available on: Kluwer Law International. Accessed 18 May 2019.
[136] *Ibid*, p.15.

more complex services and products that, evidently enough, they may not be suited to deal with.

In efforts to ensure the proper maintenance of the fiduciary role as undertaken by service providers, conduct of business rules come into play. Such regulation aims to mitigate drawbacks arising out of the information misbalance issue, and reduce the service providers' risk appetite should it become evident the client might be worse off.[137] Consequently, these rules call for certain minimum thresholds to be abided by the firm's staff prior to commencing activities, as well as regulate the ongoing client-firm relationship to ensure the maintenance of adequate client protection mechanisms throughout the transaction.[138, 139] The rationale behind mandating the utilisation of appropriately-educated individuals should subsequently ensure that the firm will continue to uphold client protection rules notwithstanding the level of leadership at the respective undertaking.

As already previously discussed, non-EU entities do not enjoy the range of freedoms as provided under the TFEU. Nonetheless, interpretation of permissible restrictions in terms of TFEU can provide much-needed assistance in assessing the suitability of current investor protection mechanisms. As per the CJEU in its ruling in *Reinhard Gebhard v Consiglio dell'Ordine degli Avvocati e Procuratori di Milano*[140] (hereinafter: *Gebhard*), a total of four preconditions are to be abided by to ensure compliance with EU law in limiting either freedom stemming from the TFEU. Given the very nature of third-country service providers, it is evident that the first condition of non-discrimination is not fulfilled in this regard,[141] although it is not necessarily needed in the current examination. As noted throughout the work, non-EU entities need not be afforded equal rights as those enjoyed by intra-European undertakings, since Treaty freedoms are inherently limited to undertakings established and licenced within the Union.[142] Nonetheless, the other three preconditions stemming from the *Gebhard* ruling could prove to be of use in assessing the justification of retail client protection mechanisms.

First and foremost, investor protection regimes are inherently motivated by and aimed at ensuring sufficient safeguards to otherwise vulnerable groups. Thus, in this regard the requirement for the restriction to be of general interest is certainly met in relation to retail clients.[143] When considering the level of exposure faced by professional clients, however, one must also take into account the plethora of thresholds and conditions professional clients abide by, therefore already highlighting one potential area of regulatory overreach.

Second, the suitability of the measure vis-à-vis the ultimate goal pursued comes into play.[144] In this regard, too, the author is not questioning the need for retail investor protection regimes. Instead, criticism is exerted in terms of *per se* professional and professional-upon-request entities. As stated above, these two distinct client categories need not be given equal preservation measures, a problem the severity of which becomes more apparent when considering the evident twofold application of protection measures.

[137] Bischof, *supra* note 121, p.1034.
[138] Goodhart, *supra* note 132, pp.6-7.
[139] Snowdon, *supra* note 68, p.18.
[140] Judgment in *Gebhard*, C-55/94, EU:C:1995:411.
[141] *Ibid*, para.37.
[142] Moloney, *supra* note 120, p.27.
[143] Judgment in *Gebhard*, *supra* note 140, paras.37-39.
[144] *Ibid*, para.39.

Last, but not least, the proportionality test is to be examined.[145] An appropriate measure will only extend as far as it is needed to reach the needed goal. Any extensions beyond what is needed will ultimately be deemed as disproportionate, and thus fail to adhere to the *Gebhard* test. Given the aforementioned, it becomes evident that the suitability of the current MiFID II regime as far as professional client protection fails the *Gebhard* test. As stated above, the application of *Gebhard* criteria as developed by the CJEU is strictly limited to intra-EU matters and cannot be extended to third-country policies. However, the author believes it to be a useful test in arguing for the need for a differentiation between retail and professional clients in terms of marketing, additional service or product offering, and further service or product type supply.

In addition to the *Gebhard* test, the CJEU's ruling in *Alpine Investments BV v Minister van Financiën*[146] (hereinafter: *Alpine Investments*) is of relevance in terms of retail clients security. Whereby the CJEU stressed the close interconnectedness between market participants' trust in the respective financial markets, and subsequent need for appropriate participant protection regimes.[147] Namely, given the immense role of investors' trust into the system, failure to provide for sufficient client protection mechanisms would thus erode the functioning of financial markets via undermining client confidence. Consequently, while in *Alpine Investments* the CJEU concluded that restrictions in one EU member state aimed at the protection of clients in a wholly separate member state cannot be substantiated according to EU law, such activities were nonetheless found to comply with the prerequisite of "general interest".[148, 149]

Notwithstanding the CJEU's relative reluctance in expressly substantiating that investor protection truly amounts to an activity of general interest,[150] its remarks and final ruling in *Alpine Investments* should serve as sufficient basis to confirm the aforesaid. Consequently, whereas retail clients are in need of a wide variety of measures aimed at safeguarding the group, applying equal ones in terms of professional clients would fail to conform to the aforesaid criteria.

4.2. RESTRICTIONS IN RELATION TO PROFESSIONAL CLIENTS

Whereas one might well argue that applying differing investor protection measures only extends as far as intra-EU financial service providers are concerned, the fact that such restrictions towards *per se* professional clients are not needed is not affected. As indicated above, Annex II of MiFID II provides for a great deal of requirements and thresholds. As long as these prerequisites are abided by, the client is deemed to be a professional client, insofar as the *per se* professional client does not explicitly request to be treated as a retail client. Given the high standards in terms of capital minimums, experience and competence levels of natural persons occupying managerial positions, and their prior experience in financial services, the treatment of professional clients under MiFID II remains most puzzling.[151] Unlike mere retail investors, professional clients are subject to strict capital adequacy standards and must adhere

[145] Judgment in *Gebhard*, *supra* note 140, para.39.
[146] Judgment in *Alpine Investments*, C-384/93, EU:C:1995:126.
[147] Moloney, *supra* note 120, pp.28-29.
[148] Judgment in *Gebhard*, *supra* note 140, paras.37-39.
[149] Moloney, *supra* note 120, p.28
[150] *Ibid*, p.29.
[151] Moloney, *supra* note 3, pp.775-778.

to sufficient educational and professional requirements. Nonetheless, these heightened requirements, as per MiFID II, do not allow professional clients to deal with a much greater level of independence. Given that the EU regulatory framework vis-à-vis investor protection has mainly been focused on retail clients, there appears to be little to none legal basis for imposing upon third-country investment service providers equal restrictions as when dealing with retail investors.

As has been pointed out by legal scholars, the other main differentiating characteristic playing in the favour of professional clients is the funds utilised. Whereas retail clients put their own assets at risk by purchasing financial services or products, professional entities by and large operate with funds received from other entities. Given that this capital has been acquired via the professional client's professional business activities,[152] this group of service recipients does not need to be subject to equal protection mechanisms as those described under the previous section. Provided that the regulatory framework allows for sufficient systematic and prudential risk minimisation mechanisms, the process of fund acquisition by professional investors over the course of their professional dealings will have been governed by appropriate investor protection regimes. Consequently, forcing retail-market appropriate norms upon professional clients results in an unnecessary twofold application of investor protection norms. In this instance, the first time the regulatory regime applies is at the moment when, say, retail clients entrust their assets upon professional entities. The second application subsequently takes place when the professional client attempts to solicit third-country firms' services in efforts to utilise funds at their disposal.

Given that it has long been the approach of EU lawmakers to ensure a relative degree of liberty vis-à-vis professional clients and their dealings within financial markets,[153] the current MiFID II marketing ban is questionable. Indeed, as outlined above, it results in the repeated application of very stringent restrictions to entities which generally do not need such protections. Moreover, MiFID II still provides *per se* professional entities the opportunity to be treated as mere retail clients, hence ensuring that a simple *prima facie* categorisation as a professional client does not bar inexperienced recipients from enjoying the needed level of safeguards. Seeing as burdensome regulations only supress service providers' appetite to enter the respective jurisdiction,[154] a step-back from European legislators is in fact very much needed.

Despite the EU’s previous approach towards professional clients, whereby lawmakers faced strong opposition against applying restrictions for professional clients resulting in similar treatment when compared to retail clients, MiFID II appears to break off from the EU’s prior approach.[155] Whereas one might well differentiate between *per s*e professional client, retail and professional-at-request clients, applying identical restrictions to all three groups under Article 42 MiFID II appears to lack any solid legal basis.

Instead, Article 42 of MiFID II ought to appropriately take into account the differences between retail and professional clients, and expressly provide for marketing and solicitation bans only insofar as retail clients are concerned. Consequently, a revision of Article 42 should afford greater freedom when interacting with *per se* professional clients and professional-at-request clients. In terms of marketing, the degree of third-country firms’ ability to market

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[152] Moloney, *supra* note 120, p.25.
[153] *Ibid*.
[154] *Ibid*, p.26.
[155] *Ibid*, pp.24-25.

their services may only be extended towards *per se* professional clients. Should it also be extended to professional-at-request clients, which originally are only retail clients, European investor protection concerns would once again be put at risk. Influenced by improper promotional activities well-suited for professional clients, retail clients would be likely to yet again underestimate the appropriateness of their investments,[156] and substantially damage households' savings.

As outlined under the previous section dealing with retail clients, proportionality and suitability considerations must be taken into account when assessing a particular restriction. It thus must be noted that a measure fails to meet either criteria, if a less-restrictive approach could be provided for. Additionally, these concepts prohibit the twofold application of equal rules.[157] Thus, seeing as professional clients utilise funds received from investors under a heavily, and appropriately, regulated regime, applying identical restrictions for yet another time evidently lacks any solid reasoning.

[156] Moloney, *supra* note 3, p.788.
[157] Moloney, *supra* note 120, p.30.

5. REVERSE SOLICITATION VERSUS "PASSPORTING"

Purely for sake of comparison, the thesis shall also take into account the notion of "passporting" of financial services. Although it is reserved merely for undertakings originating from within the borders of the Union, it shall nonetheless be of relevance in emphasising the stark restrictions provided under MiFID II. Moreover, as per settled case law and EU law itself, non-EU entities may be afforded a more favourable regime when compared to its competitors established within the Union.[158] Consequently, reverse solicitation under Article 42 of MiFID II may not provide for a less-stringent market access regime than the most lenient concept reserved for only European undertakings, i.e., the concept of passporting.

Passporting is one of the current-day cornerstone legal tools available to intra-EU financial services firms allowing them to operate throughout the Union without establishing any physical presence in other EU member states. Instead, passporting permits financial service providers to offer their products and services cross-border directly to their clients.[159] The eventual introduction of the passporting regime was a much-needed bolster to one of the basic four freedoms, namely, the free flow of capital, as it abolished the need for European financial market participants from gaining recognition and subsequent authorisation from supervisory authorities in each EU member state separately, instead providing for a relatively straightforward method of notifying the local authorities.

Passporting, however, heavily relies on the mutual recognition and support between the supervisory authorities of the home and recipient member states.[160] Therefore, in absence of a sufficiently harmonised regulatory framework, the passporting concept would fail to establish continued supervision of cross-border activities. Where the home member state's authorities might well regard the activities of a particular financial services entity fully compliant with the local laws, the supervisors in a different EU member state might not follow suit. Thus, passporting can only properly operate in environments wherein the regulatory systems are sufficiently harmonised.

Considering the aforementioned, one is able to comprehend why passporting is not permitted in relation to third-country firms. Where EU legislative acts cease to apply, no harmonisation can be ensured, and thus the supervisory authorities carrying out supervision over activities crossing the borders of the Union are unable to ensure the activities comply with the respective laws.[161]

These shortcomings can, however, be mitigated via the conclusion of memorandums of understanding between financial supervisors of European and foreign jurisdictions. However, should that ever be the case, such arrangements would unfortunately fall short of achieving an adequate level of harmonisation, therefore resulting in ineffective cross-border cooperation.

To a certain degree, reverse solicitation might well be compared to passporting. For one, both regimes provide for the utilisation of existing company infrastructures without imposing further requirements for the setting-up of, say, physical establishment in the member state

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[158] Markus Heidinger, "Austria: investment services - cross-border provisions," *Journal of International Banking Law and Regulation* (2018), p.41. Available on: Kluwer Law Online. Accessed 12 May 2019.
[159] Visekruna, *supra* note 4, p.658.
[160] *Ibid*, pp.658-659.
[161] Nemeczek, *supra* note 27, p.427.

wherein services are to be provided.[162] Nonetheless, when examining the two concepts in greater detail, this appears to be the sole shared factor, as entities carrying a European passport need not abide by advertising restrictions. Furthermore, the scope of services they may render equals to those services it is licenced to perform in the home country,[163] and it maintains the default applicability of EU law and recourse to courts located within the Union. Reverse solicitation, as outlined under previous paragraphs, is limited to the particular service requested by the client. Should the client only request one particular financial service, the third-country entity is not permitted to somehow entice the client to request further services, as that would be an evident breach of the prohibition to advertise or otherwise promote further engagement from the client.

Notwithstanding, reverse solicitation and passporting can also be likened in terms of their longevity. Neither concept, at least for the time being, should the successor of MiFID II provide for a different treatment of third-country firms, is dependent on some member state authority's approval. Instead, under both regimes member states are under the duty to recognise the undertakings' reliance on the respective concept,[164] provided the prerequisites have been abided by.

Another point of difference is the initiation of services. Under the passporting regime, national authorities must first be notified of the entity's intent to begin operating on the basis of its European passport. Whereas this might appear to be relatively harmless in terms of potential bureaucratic burdens, the main point of concern for intra-EU entities is merely the ability for the national supervisor to reject its plea.[165] Insofar as required by the respective third-country local laws, non-EU entities need not undergo such notification procedure. Additionally, as outlined above, the third-country firm must not first contact any European authority prior to rendering a service or product according to Article 42 of MiFID II.

[162] *Ibid*, p.430.
[163] Nemeczek, *supra* note 27, p.430.
[164] *Ibid*, p.427.
[165] *Ibid*, pp.427-428.

6. FUTURE OF REVERSE SOLICITATION

It has been argued that reverse solicitation is by no means a strategy that could be adopted by non-EU service providers, as it instead provides for a third-country entities to stay put until the moment an EU-based client were to actively approach them. Moreover, the current digital age allows promotional materials to reach audiences not necessarily intended to be the target audience.[166] Nonetheless, the author of this thesis foresees a future for reverse solicitation, provided that the necessary degree of change is brought about by whichever legal instrument supersedes it. The particulars of such adjustments will be dealt with under the following paragraphs.

As extensively argued by legal scholars, reverse solicitation in its current form falls short of providing third-country entities a sufficient framework for the setting-up of a long-term access point to European clients.[167, 168, 169] Nonetheless, whereas the concept's heavy reliance on a purely reactionary business model could potentially only support a very minimal number of transactions for non-EU financial service providers,[170] larger entities which have secured strong brands in the respective financial markets would not necessarily suffer nearly as much.[171] Consequently, reverse solicitation could be successfully incorporated into the business strategies of well-established entities which need not rely on heavy marketing activities to attain additional clients and secure deals. Hence, the relevance of the concept for non-EU entities must not be diminished, provided the aforesaid considerations in terms of the service providers' prominence is taken into account.

With letters dated 20 November 2017 and 26 September 2018, ESMA publicly expressed its concerns over the current reverse solicitation regime. In highlighting the fact the under reverse solicitation, EU clients would fall outside the scope of protections afforded by Union law, thus potentially posing a high degree of unwarranted risk to investors, in particular retail clients.[172] In attempting to resolve these issues, ESMA set forth a total of three potential solutions the implementation of which could mitigate the existing problems inherent to reverse solicitation, each of them addressed under the following subparagraphs.

In addressing the evident shortcoming of the AIFMD and UCITS regimes, the European Commission (hereinafter: EC or Commission) has called for the introduction of Proposal for a Regulation of the European Parliament and of the Council on facilitating cross-border distribution of collective investment funds[173] (hereinafter: Proposal), explaining that merely a legal instrument having direct legal effect can attain a sufficient level of harmonisation across

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[166] Sagan, *supra* note 91, pp.513-514.
[167] Seretakis, *supra* note 84, p.144.
[168] Charlotte Hill, "Fund Management Update," *Compliance Officer Bulletin* (2017), pp.4-5. Available on: Kluwer Law International. Accessed 10 May 2019.
[169] Niamh Moloney, "Brexit and Financial Services: (Yet) Another Re-Ordering of Institutional Governance for the EU Financial System?" *Common Market Law Review* 55(2018): p.179.
[170] Seretakis, *supra* note 84, p.144.
[171] Loizou, *supra* note 101, p.249.
[172] European Securities and Markets Authority. *MiFID II / MiFIR Third Country Regimes, Provision of Investment Services and Activities at the Exclusive Initiative of the Client and Outsourcing of Functions to Third Country Entities*, p.4. Available on: https://www.esma.europa.eu/sites/default/files/library/2018-esma35-36-1442-ipisc_uk_withdrawal_from_the_eu_letter.pdf. Accessed 28 February 2019.
[173] Proposal for a Regulation of the European Parliament and of the Council on Facilitating Cross-Border Distribution of Collective Investment Funds and Amending Regulations (EU) No 345/2013 and (EU) No 346/2013. Available at: https://ec.europa.eu/transparency/regdoc/rep/1/2018/EN/COM-2018-110-F1-EN-MAIN-PART-1.PDF. Accessed 4 May 2019.

the pan-European region.[174] On the basis of analysis conducted in reference to Article 42 of MiFID II, it is hereby submitted that in the future the reverse solicitation regime ought to be incorporated into an EU regulation, affording a preferable degree of legal certainty for third-country financial service providers servicing European clients.

While the application of identical marketing and solicitation regimes towards both retail and professional clients is questioned throughout the thesis, the work does not call for the exemption of certain product classes in a similar manner to that in terms of marketing. It has been suggested that drawing additional lines between products and services appropriate for retail clients, and those deemed to be of a far too risky nature is an exceptionally difficult task to properly undertake.[175] Moreover, with the continued emergence of new and innovative financial services that may share very little, if anything, with products currently regulated under MiFID II, lawmakers would have a far too difficult task with ensuring the Directive's relevance over time. Consequently, the work calls for differentiation in terms of promotion towards retail and professional clients, leaving the product differentiation rules unaffected.

Given that one of the core aims of MiFID II was the improvement of financial markets' efficiency,[176] a further revision of the Directive in terms of professional clients would merely supplement EU legislators' attempts in achieving this aforesaid goal. Moreover, the efficiency goal also calls for harmonisation in relation to non-EU service providers accessing European markets and clients.

6.1. MARKETING REGIME

Similarly to calls for the Proposal revising the EU regulatory framework in terms of AIFMD and UCITS funds' marketing restrictions,[177] identical EU-wide rules in terms of marketing activities under MiFID II are needed. The aforementioned EC Proposal underlines the need for increased transparency within the realm of promotion of funds,[178] which in turn is bound to improve the investor protection environment. This is especially pertinent when addressing retail clients, as they might not necessarily be able to notice misguiding advice.

Whereas the categorisation of retail and professional clients is not of significance for the purposes of reverse solicitation when assessed pursuant to the current MiFID II regime, as third-country firms may rely on reverse solicitation if either client category solicits the respective services, it still provides crucial considerations in relation to proposed revisions of Article 42 of MiFID II. As argued previously, there is little to no legal basis for subjecting professional clients to restrictions identical to those relevant for retail clients. Moreover, it has been submitted that the current rules are disproportionate and have no justifiable legitimate aim. Therefore, a revised reverse solicitation regime under MiFID II should differentiate between the treatment of retail and professional clients.

The Proposal would provide for marketing materials to be clearly construed and perceived by the target audience as marketing information. Moreover, entities distributing units in funds would be obliged to expressly provide for risks associated with the particular financial

[174] *Supra* note 173, p.4.
[175] Moloney, *supra* note 2, pp.791-793.
[176] Weitnauer, *supra* note 8, p.455.
[177] *Supra* note 173, p.10.
[178] *Supra* note 173, Recital 2.

product, not only promote the potential returns.[179] Moreover, marketing material would have to contain information pertaining to additional financial documents and statements allowing would-be investors to examine the suitability of their intended investment.[180]

More crucially, the Proposal would provide for an explicit definition of activities amounting to pre-marketing. The scope of the pre-marketing regime would, however, be rather limited, as it would only refer to marketing activities covering funds that have not yet been established,[181] with references to existing funds and entities exempted from the scope of permitted pre-marketing activities. Additionally, AIFMs would be barred from undertaking pre-marketing activities in relation to retail clients, with the Proposal permitting it only in relation to professional investors.[182] In essence, pre-marketing activities would merely permit managers to "test the waters" and assess potential investors' interest in committing to a potential fund.

Consequently, all and any marketing activities could only contain general information pertaining to "strategies or investment ideas"[183]. Given that the concept of pre-marketing would not be extended to already incorporated and registered or licenced funds, would-be investors could not be presented with the opportunity of already committing their funds to the upcoming fund. Similarly, concrete prospectuses and other documentation required for the establishment of funds would exceed the scope of pre-marketing, as merely drafts without the possibility of subscription thereto would be permitted.[184] These restrictions severely limit the potential benefits of pre-marketing activities, as fund managers would be allowing to disseminate overall general ideas without disclosing specifics. Nonetheless, these recommendations would increase legal certainty by providing for an explicit definition of pre-marketing, therefore partially eliminating yet another possibility to rely on regulatory arbitrage. The scope of changes to be brought about by any such amendments will still be reliant on the whether AIFMD is succeeded by a directive or a regulation, with the former calling for national transposition. As discussed before, such second step at the level of national member states' legislatures has proven to bring about further exemptions or restrictions not necessarily called for the by base document itself.

Much to the detriment of non-EU entities, however, pre-marketing activities would be permitted only in relation to European AIFMs. Despite the possibility to yet again utilise regulatory arbitrage and rely on gaps in the revised regime, it should be noted that European member states have been expressly barred from adopting a more lenient approach when regulating third-country entities, compared to restrictions imposed upon intra-EU AIFMs.[185] Notwithstanding, the proposed definition of "pre-marketing" would differ significantly from the current understanding of the regime, as it would no longer refer to activities not amounting to "marketing" in the strictest sense. Instead, by providing a definition of the notion in terms of a proposed AIF yet to be established, the concept would be heavily altered. Whereas the proposed changes have been met with widespread praise,[186] it would no longer

[179] *Supra* note 173, Article 2(1).
[180] *Ibid*, Articles 2(2)-2(3).
[181] Loizou, *supra* note 101, pp.247-248.
[182] *Supra* note 173, p.18.
[183] *Ibid*.
[184] *Ibid*.
[185] Loizou, *supra* note 101, p.248.
[186] *Ibid*.

be of much use in the interpretation of the regime under MiFID II in light of the resulting wording.

6.2. REQUIREMENT TO DEMONSTRATE CLIENTS' OWN EXCLUSIVE INITIATIVE

ESMA, in its aforementioned communique, sets out as the first proposal the requirement to have non-EU financial service providers demonstrate to national regulatory authorities the own exclusive initiative of the respective client, should the firm receive such request from national authorities.[187] As analysed in greater detail under section No. 3.1, third-country service providers ought to maintain proper internal records substantiating the fact of the particular client's exclusive initiative in approaching the firm to solicit financial services and products, as failure to do so may well result in the national supervisory authorities presuming one of the core prerequisites under Article 42 MiFID II has not been met.

At the same time, not all national regulators will accept simple affirmations from clients as sufficient basis to ascertain that the respective client did approach the firm on their own initiative. Consequently, the exact procedure for demonstrating the client's own initiative must be set forth by EU law. One may well choose to pursue the current approach of the UK's authority, which permits the use of confirmations received from clients. Absent any other concrete approach that could, on the one hand, truly work in practice, and, on the other hand, not cause too big of a headache to third-country firms in terms of widespread record-keeping requirements, this tested and tried method could serve as a solid basis for redefining Europe's approach towards reverse solicitation.

MiFID II has thus placed third-country firms in a peculiar position. On the one hand, access to EU-based clients appears to be as effortless as never before. On the other hand, however, the possibility to demonstrate the exclusive initiate of the client in approaching the firm seems to be a mere afterthought. While this requirement must be complied with to rely on Article 42 of MiFID II, at the same time it remains unclear as to how to document this. Requiring confirmations from recipients of such services would provide for some much-needed relief to third-country firms. However, this could well lead to dishonest disclosures provided by retail clients under the persistent pressure of the respective non-EU entities.

This dilemma could be solved via the imposition of a dual client-firm confirmation, whereby both parties separately would vouch for the transaction's compliance with the limitations as set forth by Article 42 of MiFID II.

6.3. RECOURSE TO EU COURTS

Given the considerations of marketing activities under Article 42, MiFID II appears to draw two separate abstract borders. Namely, the activity solicited by the client on the basis of reverse solicitation is seen as having been performed outside the territory of the Union, whereas the relationship between the client and the firm nonetheless somehow remains within the EU, at least in relation to marketing activities and solicitation. MiFID II creates an artificial enclave within the Union wherein EU law, at least to a partial degree, has no jurisdiction. This aspect appears to be a major oversight of European legislators, who apparently intended, on the one hand, to exclude the application of EU investor protection

[187] European Securities and Markets Authority, *supra* note 172, p.4.

measures to services provided under reverse solicitation, and, on the other hand, still wished to eliminate marketing activities by third-country entities without branches located in the Union.

As put forth by ESMA, another possible solution would be to remove any reference to the automatic exclusion of intra-EU courts. As discussed above, nothing under MiFID II prohibits parties to a particular contract to agree upon the jurisdiction of European courts in settling disputes, should any arise. Nonetheless, given Recital 111 of MiFID II, which stipulates that when operating pursuant to Article 42, "the services should not be deemed as provided in the territory of the Union"[188], Brussels I bis does not lead to a *prima facie* recourse to EU courts. Whereas jurisdictional questions are exclusively dealt with by Brussels I bis, a potential change in jurisdiction could also alter the applicable law, hence the following shall also provide for a brief reference to an interpretation of Rome I.

Presuming that one can ensure compliance with the above prerequisites, both MiFID II and Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments[189] (hereinafter: MiFIR) stipulate that such services will not be deemed to have been provided within the territory of the EU,[190, 191] which in turn excludes the automatic applicability of EU laws and access to European courts. Consequently, this approach raises further issues pertaining to both legal certainty and investor protection. Moreover, the dispute resolution mechanism applicable to transactions based on reverse solicitation becomes rather complicated when compared to services rendered by firms established within the Union. Therefore the next subparagraphs shall be dedicated to a comprehensive assessment of the two current EU regulations governing the applicable law and jurisdiction issues in relation to disputes of "civil or commercial nature"[192].

It must be noted that provisions under neither MiFID II, nor MiFIR prevail over the parties' ability to exercise their rights stemming from Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations[193] (hereinafter: Rome I) and Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters[194] (hereinafter: Brussels I bis). Among the other suggestions as to possible revisions of MiFID II, ESMA put forth the *prima facie* jurisdiction of intra-EU courts in case of disputes arising out of services provided pursuant to Article 42 of MiFID II. The necessity of this, however, remains questionable. In this regard, the application of Rome I and Brussels I bis as regards financial services contracts between third-country firms and EU service recipients shall also be taken into account.

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188 *Supra* note 9, Recital 111.

189 Regulation (EU) No 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments, OJ L 173, 12.6.2014.

190 *Supra* note 9, Recital 111.

191 *Supra* note 189, Recital 43.

192 *Infra*, Article 1(1).

193 Regulation (EC) No 593/2008 of the European Parliament and of the Council of 17 June 2008 on the law applicable to contractual obligations, OJ L 177, 4.7.2008.

194 Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 351, 20.12.2012.

6.3.1. Jurisdiction, and applicable law

Should the necessary amendments be made, pursuant to Article 7(1)(b) of Brussels I bis even in absence of any express contractual agreement between the parties would courts of the respective member state wherein the service was provided have jurisdiction to adjudge the particular dispute.[195] However, the effectiveness of this is questionable. First and foremost, the parties would still be at liberty to opt for some other jurisdiction via the mere insertion of a short yet decisive dispute resolution clause. Second, such alterations to MiFID II would result in undertakings wholly foreign to European law suddenly facing litigation before intra-EU courts. Hence, third-country firms would face yet another powerful deterrent to entry into the European market. At the same time, however, the issue could be seen from the viewpoint of retail investors, to whom litigation of any sort, let alone before courts of third-countries would be more than problematic.

Consequently, the presumed recourse to European courts could, in fact, be welcomed, but it is certainly not of essence. Where retail clients could unintentionally benefit from the rule should any issues arise in the provision of the particular service or product, more-experienced clients could easily avoid having to litigate before intra-EU courts by incorporating a specific dispute resolution clause favouring the use of a non-EU court. Thus, parties which are well aware of this mechanism and thus believe to be able to benefit from such additional agreement would not be prohibited from doing whatever they deem to be best for the particular transaction, whereas retail clients would continue to enjoy the protection of European courts.

Following an interpretation of Article 1 of Rome I, disputes arising out of or in relation to services rendered by third-country undertakings to individuals in the EU, be it professional or retail clients, would still fall under the scope of the Regulation.[196] Furthermore, Rome I does not prohibit the application of the law of non-EU countries under Article 2, should its conflict of laws provisions lead to the applicability of the law of a third country.[197]

Absent any choice-of-law provision under the particular contract, Article 4(1)(b) stipulates that contracts for the provision of financial services on the basis of reverse solicitation will be governed by the law of the country of incorporation of the service provider.[198] Nonetheless, as a general rule under Article 3 Rome I, parties to a contract may well choose a law at their own discretion,[199] therefore providing the opportunity to avoid the application of complex foreign laws. Given that the service will be seen as having been provided outside the territory of the EU, it may well be wise to integrate the respective foreign jurisdiction's law as applicable under the respective provision of services or product agreement. Should that not be the case, the litigation process, whereby a judge of the respective third-country court would have to apply a wholly foreign set of rules could well complicate any dispute resolution attempts.

However, the recipient classification regime is also of essence in applying the relevant rules stemming from both Rome I and Brussels I bis. Whereas professional clients under MiFID II must adhere to specific criteria, both of these Regulations instead take into account whether the transaction was carried out within the scope of the client's professional dealings.[200]

[195] *Ibid*, Article 7(1)(b).
[196] *Supra* note 193, Article 1.
[197] *Supra* note 193, Article 2.
[198] *Supra* note 193, Article 4(1)(b).
[199] *Supra* note 193, Article 3.
[200] Opinion of Advocate General Tanchev in *Petruchová*, C-208/18, EU:C:2019:314, paras.44-45.

Without necessarily taking into account the client's background in terms of their profession and education,[201] a natural person categorised under MiFID II as a professional entity might still enjoy protections stemming from either Regulation. Such separation of the client's competencies and the transaction itself could well have unintended consequences for non-EU entities entering into contracts with EU clients under the presumption that clients adhering to the professional client category under MiFID II need not be afforded "economically weaker"[202] party protections stemming from Rome I and Brussels I bis. Moreover, it has been submitted that neither the frequency of transactions, nor the scope of investments in terms of the size of assets involved are to have any influence in ascertaining the applicable provisions in terms of jurisdiction and applicable law issues.[203]

Considering the above comments in relation to a proposed jurisdiction change, and accounting for the conflict-of-laws provisions of Rome I, it is hereby submitted that such changes would need to be broader in scope to allow for an efficient dispute resolution process. Should the service provided be presumed to have taken place within the borders of the EU, while the parties would subsequently apply the law of the country of registration of the third-country entity, litigations would become rather complicated. Having presumably European-educated judges serve on panels whereby the law of a completely foreign jurisdiction is to be applied could very likely lead to unnecessarily lengthy court proceedings due to the involved parties' inexperience in dealing with the respective law.

6.4. REVISION OF ARTICLE 42 MIFID II

It can well be argued that ensuring non-EU firms’ access to the internal market of the EU will only benefit the business environment, giving clients a broader choice of service providers, fostering their ability to tailor their investment choices according to each client’s respective needs. Considering that limitations imposed upon competition between intra-EU entities are undoubtedly harmful, the same argument can be extended to include cross-border competition with undertakings incorporated in foreign jurisdictions.

Furthermore, an interconnected system which allows foreign entities to access the EU market could well lead to a more stable internal market better suited to weather internal crises that do not affect foreign jurisdictions.[204] Nonetheless, a counterargument may well be launched against the second notion, as opening the EU market to foreign entities will ensure that instabilities in the respective foreign markets will inevitably echo within the EU. However, this double-edged sword appears to be much less harmful when taking into account well-established competition law notions, which generally regards restrictions upon competition as detrimental to the market.

Therefore, it is hereby submitted that albeit a revision of Article 42 is of essence, any such changes must not lead to third-country entities being barred from access to the EU. Instead, a future Article 42 of MiFID II should first and foremost refrain from imposing limitations in relation to professional clients.

When drafting the successor of MiFID II, European lawmakers must take into account a number of problematic areas of relevance for reverse solicitation. First and foremost, the most

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[201] Judgment in *Schrems*, C-498/16, EU:C:2018:37, para.39.
[202] *Supra* note 200, para.49.
[203] *Ibid*, paras.50-51.
[204] Visekruna, *supra* note 4, p.660.

crucial terms must be clearly defined under the Directive. These would include the notions of "marketing", "general public", "large group of clients or potential clients"[205], and "large category of clients or potential clients"[206]. Failure to provide harmonised interpretation of the above terms has led to the very existence of this thesis, as the uncertainty behind reverse solicitation was the main basis for conducting research on this topic in the first place.

Given the very nature of directives, however, efforts to provide for a harmonised environment for third-country firms might not go as far as necessary even when providing for the above shortcomings. As highlighted by national transpositions of the AIFMD, and considering other arguments raised throughout the work, the current reliance on national transpositions has resulted in a mix of jurisdictions interpreting reverse solicitation in an inconsistent manner.[207] In its current iteration, MiFID II explicitly provides that third-country entities are to rely on national regulatory regimes,[208] which might not provide for a sufficiently harmonised regime vis-à-vis non-EU service providers. Whereas Recital 107 of MiFID I is clearly intended to be applied only in relation to intra-EU firms, it is hereby submitted that it must be extended to a degree which would permit third-country entities to have "the same opportunities of joining or having access to regulated markets throughout the Union"[209], at least as far as professional clients are receiving services.

Subsequently, taking into account the legal status of MiFID II and the above considerations, it is hereby submitted that reverse solicitation must be incorporated under a regulation, as regulations do not require national transpositions. Consequently, the European financial services market would provide for a harmonised regulation of relevance for non-EU entities operating on the basis of reverse solicitation regardless of the particular EU member state wherein the service is provided, or wherein the firm's marketing activities are executed.

6.4.1. Reverse solicitation versus equivalence regime

Should the aforementioned changes be adopted, resulting in third-country firms gaining access to European professional clients on the basis of reverse solicitation without marketing and investor protection concerns, the reverse solicitation regime would largely mirror that of the concept of equivalence.[210] While such duplication is unnecessary, the following paragraphs shall argue that the two regimes are not necessarily equal and thus the changes to Article 42 of MiFID II are still very much needed, as it will be submitted that equivalence cannot substitute reverse solicitation.

Under the equivalence regime as provided for by Article 46 of MiFIR, third-country firms may also service "eligible counterparties and … professional clients"[211] on a cross-border basis within the EU following the adoption of an equivalence decision by the EC and the firm's subsequent registration into a register maintained by ESMA.[212, 213] The equivalence decision, should it be supported by the Commission, first, affirms the conformity of the third-country's financial regulatory environment with that of the EU, and, second, acknowledges

[205] *Supra* note 9, Recital 85.
[206] *Ibid*.
[207] Nemezcek, *supra* note 27, p.460.
[208] *Supra* note 9, Recital 109.
[209] *Supra* note 9, Recital 107.
[210] Berger, *supra* note 25, p.214.
[211] *Supra* note 189, Article 46(1).
[212] Nemezcek, *supra* note 27, p.444.
[213] *Supra* note 189, Article 46(1).

the quality of the regulatory environment of that third-country,[214, 215] essentially deeming the two jurisdictions compatible and providing for sufficient investor protection mechanisms.

The very first limitation under the equivalence regime is its exclusion of retail clients, since entities which are deemed to already be governed under sufficiently rigorous third-country laws would still not gain access to European retail clients.[216, 217] Having provided little to no guidance as to the exact criteria to be applied in assessing the compatibility between the laws of the EU and those of the third-country,[218] the possibility to obtain a favourable equivalence decision might well guarantee non-EU entities the same mediocre level of legal certainty. Moreover, the temporal effect of such equivalence decision remains highly concerning. Following the three-year transitional period of the decision adopted by the EC, third-country firms may no longer rely on the decision and will once again find themselves barred from interacting even with eligible counterparties and professional clients.[219] Furthermore, the EC equivalence decision may well be revoked at any time,[220] should the Commission deem that the two jurisdictions are no longer sufficiently harmonised or similar.[221] MiFIR does not provide for any sort of prior notification towards the third-country firms operating under the equivalence regime, therefore rendering the reliance on Article 46 of MiFIR particularly precarious.

In reference to the above remarks alleging the supposed likeness of reverse solicitation and the equivalence regime, it must be noted that the scopes of the two concepts are significantly different. For one, reverse solicitation covers both retail and professional clients, whereas non-EU entities may not interact with European retail service recipients even under the Article 46 of MiFIR. Furthermore, MiFIR does not provide for anything akin to Recital 85 of MiFID II, namely, the separation between marketing activities of general nature, and those aimed at specifically influencing the client to initiate a transaction. Thus, marketing restrictions under MiFIR appear to be even more restricted than those under MiFID II, a peculiarity that appears to be even more confusing when considering that reverse solicitation is open also for retail clients. Given the extensive retail investor protection concerns as outlined above, restrictions towards eligible counterparties and professional clients under MiFIR being stricter than those applicable in relation to retail clients under MiFID II make little to no sense.

[214] Weitnauer, *supra* note 8, p.454.
[215] *Supra* note 189, Article 47.
[216] Snowdon, *supra* note 68, p.31.
[217] Barnabas Reynolds and Thomas Donegan, "Brexit - Opportunity for a Reboot of Financial Regulation," *Journal of International Banking Law and Regulation* 31(2016): pp.614-616.
[218] Niamh Moloney, "Brexit, the EU and Its Investment Banker: Rethinking 'Equivalence' for the EU Capital Market" *LSE Law, Society and Economics Working Papers* 5(2017): pp.21-23.
[219] Nemeczek, *supra* note 27, p.444.
[220] Nemeczek, *supra* note 27, p.445.
[221] Nemeczek, *supra* note 27, p.449.

7. Conclusion

Having addressed the most pertinent components that form the very concept of Article 42 of MiFID II, the research question as set forth in the introduction of this work may finally be addressed. Thus, on the basis of the preceding analysis it is hereby submitted that the scope of Article 42 MiFID II, on the one hand, is too restrictive while its wording, on the other hand, is too ambiguous, resulting in a high risk of unintentional breach of its scope by third-country financial service providers.

On the basis of analysis performed throughout this thesis, the relatively succinct Article 42 contains a worryingly large number of completely un- or merely ill-defined concepts, especially in terms of "marketing", and "own exclusive initiative". In absence of any concrete and sufficiently broad clarifications by European authorities, third-country service providers would yet again fall victim of a patchwork of national regulatory regimes with wildly different views as to what one and the same concept as incorporated under MiFID II truly means.

At the same time, third-country undertakings under the current MiFID II regime are tremendously restricted when intending to establish relationships with European clients. Since marketing activities could likely be banned in terms of either client category, and given that an explicit reference as to the temporal application of the marketing ban is absent from MiFID II, non-EU entities must either proceed with a very minor degree of legal certainty, or terminate plans to conduct business with European clients altogether. Additionally, one must yet again refer to Recital 85 of MiFID II. Despite the extensive analysis undertaken throughout this thesis, it is still not necessarily clear as to what is the exact scope of permitted third-country firms' marketing activities.

Thus, the most severe shortcomings in terms of reverse solicitation are exemplified by the client categorisation and subsequent investor protection regime under MiFID II. Not only are professional clients treated with the same degree of effort as retail clients, restrictions provided by the Directive do not differentiate between the two very distinct groups. Marketing is banned in relation to both retail and professional clients equally, notwithstanding the severe thresholds European clients need to meet in order to conform to the professional client category. Hence, even though the professional client categorisation mechanism has been specifically designed as to only incorporate service recipients with suitable capital cushions, and tremendous professional experience, just to name a few, *per se* professional clients are still looked after much like retail clients.

While this degree of care extended to entities that might not necessarily need or even wish to be subject to the same restrictions, their limited access to services must be appropriately underscored. As indicated above, professional clients most often are legal persons that do not act on a whim, and limit themselves to investment activities as provided for by their internal guidelines and policies. Thus, it seems contrary to the current MiFID II client categorisation regime to put aside professional clients' competences and instead limit access to sought-after products and services. Whilst a successful line of argumentation could well celebrate the supposed achievements in terms of retail client protection within the EU, as non-European entities could be seen as completely barred from promoting their services towards European clients, one must not neglect the lost opportunities for professional clients.

Moreover, as indicated under section No. 4 covering client protection regimes, measures must be proportionate and not extend beyond what is needed. These core concepts appear to be breached when reviewing restrictions applicable in terms of professional clients, and thus a revision of Article 42 of MiFID II is, indeed, needed, albeit the proposed changes might not necessarily fully align with those called for by ESMA.

By setting up a more liberal playing field in terms of access to *per se* professional clients, third-country entities and service recipients alike would benefit from freedoms in terms of marketing. For one, non-EU entities would no longer have to fret about marketing activities from decades ago, which at the moment appear to be capable of preventing the use of reverse solicitation. Moreover, by explicitly permitting broader marketing activities as outlined under Recital 85 of MiFID II to non-EU entities, professional clients could well become acquainted with innovative services and products capable of generating lucrative returns.

Whilst MiFID II in its current wording could be interpreted as already granting third-country entities sufficient marketing freedoms insofar as reverse solicitation is concerned, this apparent uncertainty in and of itself signifies one of the core weaknesses of the Directive. Without an explicit confirmation as to the applicability of Recital 85 in the activities of third-country firms, and given its extremely inconsistent use of wording when compared to MiFID II overall, non-EU entities simply do not enjoy a sufficient degree of legal certainty when dealing with European clients.

The described risks in relation to permitted marketing regimes, and inadvertent licencing and registration breaches thus form a powerful deterrent to third-country financial service providers from ever engaging with EU-based clients. Consequently, the research question as set out in the introduction of this work is thus reaffirmed, subsequently allowing one to put forth a number of suggestions as to the future of the reverse solicitation regime, provided it will not face an immediate demise given its current state.

The author of this thesis has time and time again called for certain de-regulation in terms of Article 42 of MiFID II. Nonetheless, on the basis of European investor protection measures, such liberalisation efforts certainly must not be allowed to go too far. Consequently, Article 42 of MiFID II must be liberalised only insofar as *per se* professional entities are concerned. Should the same degree of loosening up be extended to the most vulnerable service and product recipient bodies, yet another crisis within the European financial markets would surely soon follow. The aforesaid is based on the most innate characteristics of retail clients, as they are and will forever remain particularly susceptible to misleading marketing practices, opportunistic service providers, and unintended exposures to large risks. Hence, changes in the marketing regime should only be extended as far as *per se* professional clients are concerned.

However, sufficient levels of pan-European harmonisation cannot be achieved in the absence of an EU regulation. While this might just prove to be a too drastic of a change, a directly-applicable regulation would eliminate most, if not all, concern areas for third-country undertakings. Instead of having to look out for jurisdictions which either "gold-plate" the respective national measures transposing EU law, or fail to incorporate certain concepts overall, the incorporation of the reverse solicitation regime in a regulation would achieve a level of harmonisation not yet seen in terms of the Article 42 notion. However, in drafting of such regulation, the current shortcoming of MiFID II must be taken into account. Should it ever see the light of the day, such regulation must incorporate concrete definitions of marketing, since the failure of MiFID II to provide for a well-rounded definition of "marketing" is evidently one of the most pressing issues in attempting to analyse the reverse solicitation regime. The current Directive's excessive and continued reliance on vague phrases such as "own exclusive initiative", along with "new categories", "marketing", and "pre-marketing", not to mention concepts stemming from Recital 85, have contributed to the sea of differing interpretations and the overall quality of uncertainty.

As proven by the very wording of MiFID II and the respective scholarly debate, there is very little consensus as to what exactly the Directive permits to non-EU entities when it comes to its marketing regime. In altering the marketing regime, one must also finally provide for concrete definitions, at least as far as the very cornerstone notions of Article 42 are concerned. Thus, the concept of "marketing" ought to be clearly outlined under a revised MiFID II. However, as underlined previously, the replacement of MiFID II must ensure continued relevance over the years despite technological and other advances. Thus, marketing ought to be defined by emphasising the end goal sought, and effect of such activities, as opposed to merely focusing on the various methods and channels through which the concept of "marketing activities" could be shaped.

Regard must still be had to case law of the CJEU. Time and time again has the court explicitly pointed out that restrictions in relation to third-country service providers are merely side effects, and non-EU entities may not invoke TFEU provisions pertaining to the freedom of capital movement in attempting to justify barrier-free access to European markets.[222] This does not, however, prohibit reliance on, say, the MiFID II regime in accessing EU financial markets, and secondary law instruments are needed in ensuring a level playing field. In this regard, the possibility to introduce the reverse solicitation regime under a regulation must be underlined, as national transpositions cannot ensure the necessary uniform approach towards specific regimes requiring homogenous interpretation throughout the Union.

[222] Judgment in *Fidium Finanz*, *supra* note 16, para.53.

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