

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

## The retail investor and the EC

### I. The importance of the retail markets

This book examines the nature of retail investor protection. It considers the protections which do, and those which should, apply to individual, private investors<sup>1</sup> who purchase investment products, take investment advice, carry out direct trading and, overall, engage in short-term speculation or long-term savings through market-based instruments.<sup>2</sup>

Its case study is the massive EC regulatory regime for the retail investment markets. This regime has grown exponentially in recent years and now dictates the nature of retail investor protection 'on the books' for the twenty-seven Member States of the European Union. But, as discussed throughout the book, retail market protection is not simply a function of 'law on the books'. Effective retail market protection depends heavily on 'law in action'.<sup>3</sup> And 'law in action', in terms of, for example, innovative supervisory strategies, product design initiatives, retail market research, investor redress and investor education, is largely the preserve of the Member States. The book's main case study for domestic 'law in action' is the UK and the Financial Services Authority's increasingly strenuous efforts in the retail markets.<sup>4</sup> But the book adopts a generally comparative approach,

<sup>1</sup> Although the terms 'consumer' and 'investor' are sometimes used interchangeably in this area, notably by the UK Financial Services Authority (FSA), the distinction can be meaningful: sect. III below and ch. 2.

<sup>2</sup> It is not, accordingly, concerned with banking, insurance and pension-related services and products although, as discussed throughout the book, investment product innovation has placed considerable strains on the traditional regulatory segmentation between the banking, insurance and investment sectors.

<sup>3</sup> Ch. 2 considers 'law in action'.

<sup>4</sup> These include: FSA implementation of the behemoth Markets in Financial Instruments Directive regime (Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC, OJ 2004 No. L145/1 ('MiFID')) and Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

drawing on international experience and experience in the other Member States.

Why consider the retail markets and retail market regulatory design? As discussed in chapter 2, the financial crisis has wreaked destruction on household market savings; it calls for careful consideration of the role of regulation in the retail markets. But, before the financial crisis, the retail markets were worthy of close attention. Greater responsibility for financial planning and welfare provision, including with respect to pension provision,<sup>5</sup> is being imposed on individuals and households internationally;<sup>6</sup> welfare is increasingly being privatized and governments are seeking stronger individual financial independence. Risk is accordingly being transferred from government to households.<sup>7</sup> Direct household participation in the markets<sup>8</sup> is increasing;<sup>9</sup> IOSCO, for example, has

conditions for investment firms and defined terms for the purposes of that Directive, OJ 2006 No. L241/26 ('MiFID Level 2 Directive') and the related extensive reforms to the FSA's retail market conduct-of-business regime, in particular (chs. 4 and 5); the FSA's embrace of a 'more-principles-based' regulation strategy (chs. 2 and 4); continuing efforts on the pivotal 'Key Features Document' for retail investment products (ch. 5); burgeoning financial capability initiatives (ch. 7); ever-deepening research efforts (ch. 2); and radical and far-reaching reform of the investment product distribution and advice regime under the Retail Distribution Review (ch. 4).

<sup>5</sup> E.g. S. Benartzi and R. Thaler, 'Naive Diversification Strategies in Defined Contribution Savings Plans' (2001) 91 *American Economic Review* 79; and *Ageing and Pension System Reform: Implications for Financial Markets and Economic Policies* (2005) (a report prepared at the request of the Deputies of the G10 by an experts' group chaired by I. Visco, Banca d'Italia) ('G10 Report'), identifying the importance of savings products which are complementary to pension products and which provide diversification (pp. 15 and 17).

<sup>6</sup> E.g. C. Borio, *Change and Constancy in the Financial System: Implications for Financial Distress and Policy* (2007), ssrn abstractid=1022874 and European Commission, Minutes of First Meeting of the Expert Group on Financial Education, 7 October 2008. The Dutch financial market regulator (the AFM), for example, has highlighted that more responsibility is being placed on citizens and noted the 'democratization' of financial options: AFM, *Policy and Priorities for the 2007–2009 Period* (2007), pp. 11 and 12.

<sup>7</sup> This point has been made in a range of studies. E.g. J. Delmas-Marsalet, *Report on the Marketing of Financial Products for the French Government* (2005) ('Delmas Report') and Subgroup (of the Council of the EU's Financial Services Committee) on the Implications of ageing on financial markets, *Interim Report to the FSC* (FSC4180/06, 2006) ('FSC Report'). The rise in defined benefit schemes, for example, has been described as turning employees into investors and as underlining the importance of securities market regulation: M. Condon, 'Rethinking Enforcement and Litigation in Ontario Securities Regulation' (2006) 32 *Queen's Law Journal* 1, 6.

<sup>8</sup> Other than the exposure to the markets which pension schemes and insurance products achieve.

<sup>9</sup> Particularly by older investors. 'Baby boomers' control more than US\$13 trillion in household investable assets, or over 50 per cent of total US household investment assets: SEC,

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

highlighted increased levels of retail investor participation internationally in collective investment schemes (CISs) and identified the securities markets as central to individual wealth.<sup>10</sup> And the financial markets have, as a result, become significant politically.<sup>11</sup>

In the UK, the retail investment markets have become the focus of close regulatory and policy attention. The FSA's current attention to the effectiveness of investment advice 'in action' (chapter 4), for example, reflects FSA concern to support effective investment advice and product distribution structures given government withdrawal from welfare provision, changing spending and saving behaviour, shifting employment patterns and other socio-economic factors which are placing pressure on long-term savings.<sup>12</sup> Its annual Financial Risk Outlooks repeatedly highlight the increased pressure being placed on individuals and households to become financially independent and the risks which arise from failure to do so. The 2005 Outlook, for example, identified increased longevity, health risks (including obesity risks), increased individual responsibility for financing education, changing patterns of employment (particularly an increase in part-time and self-employed workers) and the need for long-term savings in support of pension provision as significant trends that could (or should) influence individuals' financial planning; it also highlighted the risks of over-reliance on property investments.<sup>13</sup> In 2006, the FSA highlighted the risks posed by individuals' failures to address pension provision as well as the stresses placed on financial planning by, amongst other factors, lifestyle changes and child-care; similar concerns were highlighted in 2007.<sup>14</sup> The choices faced by individuals are also becoming increasingly complex as governments encourage market participation and as the industry reacts. Complex retail investment products are burgeoning,<sup>15</sup> as are government

North American Securities Administrators Association and FINRA, *Protecting Senior Investors: Compliance, Supervisory and other Practices Used by Financial Services Firms in Serving Senior Investors* (2008) ('SEC Senior Report'), p. 1. In the UK, three in eight families (with a member between the ages of 50 and 64) hold some form of investment, whether directly or through some form of wrapper: FSA, *Asset Ownership, Portfolios and Retirement Saving Arrangements: Past Trends and Prospects for the Future* (Consumer Research No. 74, 2008), p. 1.

<sup>10</sup> IOSCO, *Objectives and Principles of Securities Regulation* (IOSCO, 2008), p. 1.

<sup>11</sup> Zingales has suggested that the massive increase in the use of financial markets for retirement purposes has made them much more important politically: L. Zingales, *The Future of Securities Regulation* (2009), ssrn abstractid=1319648, p. 2.

<sup>12</sup> FSA, *A Review of Retail Distribution* (Discussion Paper No. 07/1, 2007) ('2007 RDR'), p. 17.

<sup>13</sup> FSA, *Financial Risk Outlook 2005*, pp. 33–40 and 43.

<sup>14</sup> FSA, *Financial Risk Outlook 2006*, pp. 71–4 and *Financial Risk Outlook 2007*, pp. 77–82.

<sup>15</sup> See further ch. 3.

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

initiatives to encourage long-term and market-based savings; the UK Child Trust Fund, for example, provides some limited exposure to the markets.<sup>16</sup>

The need for stronger financial independence, and for effective and responsive retail markets, has been repeatedly highlighted by the Community institutions. Political direction has come from the Council of the European Union, which has called on governments to strengthen the tools with which they monitor household savings and to increase their efforts to raise households' awareness of financial education and information needs.<sup>17</sup> The Council's powerful Financial Services Committee has engaged in a wide-ranging review of the implications of ageing populations for financial markets, highlighting the macro-economic and demographic trends which are leading to pressure on households to increase market-based savings;<sup>18</sup> while governments and financial institutions (such as pension funds) have traditionally intermediated the risks of market investment, the Committee reported that they are now increasingly being carried directly by households.<sup>19</sup> The European Parliament, often sceptical of the financial markets, has acknowledged that societal and lifestyle changes demand sound management of private finances and has related better financial literacy to lower levels of problem debt, increased savings and adequate retirement provision.<sup>20</sup> A similar concern has come from the Community's executive, the European Commission. In its 2007 Green Paper on Retail Financial Services it argued that ageing populations and increasing pressure on public finances presented 'clear challenges for consumers and investors' and highlighted the need for a 'competitive, open and effective market for long-term savings'.<sup>21</sup> Earlier, its 2005 White Paper on Financial Services called for a boost in the efficiency of pan-European markets for long-term savings products.<sup>22</sup> The need for regulatory policy to support long-term savings through the markets has also emerged

<sup>16</sup> See further ch. 2.

<sup>17</sup> ECOFIN Conclusions, 2798th Meeting, 8 May 2007, Press Release, pp. 10–11.

<sup>18</sup> *FSC Report*. The dependency ratio (or the proportion of the population aged over 65 as a proportion of the population aged 15–64) is expected to increase from 24 per cent in 2003 to 51 per cent in 2050 (p. 5) and substantial strain is accordingly expected on public pension schemes (pp. 5–10). The Report suggested that higher levels of savings may be required following changes to pension provision and to medical subsidies but that 'investment in riskier assets' may reduce the need for additional savings (p. 11).

<sup>19</sup> *Ibid.*, pp. 14–16.

<sup>20</sup> European Parliament, *Resolution on Improving Consumer Education and Awareness on Credit and Finance* (P6–TA(2008)0539, 2008), paras. A and B.

<sup>21</sup> European Commission, *Green Paper on Retail Financial Services in the Single Market* (COM (2007) 226), p. 11.

<sup>22</sup> European Commission, *White Paper on Financial Services (2005–2010)* (COM (2005) 629), p. 4.

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

as a marked theme of the current debate on the treatment of substitute investment products.<sup>23</sup>

Regulators internationally are also increasingly addressing the risks faced by older and retired investors. The FSA has reviewed how the financial services market operates for older consumers and highlighted poor understanding of retirement and associated products and services and difficulties with access to advice;<sup>24</sup> it has also underlined the particular vulnerability of older investors to share scams.<sup>25</sup> Internationally, the US Securities and Exchange Commission (SEC) has also focused closely on the protection of 'senior investors', adopting investor education programmes, highlighting and prosecuting frauds and scams to which senior investors may be vulnerable, and providing guidance to financial services firms.<sup>26</sup>

In this environment, the resilience of investor protection and the appropriateness of efforts to promote individual engagement with the markets become of central importance.

## II. The retail markets and the EC

### 1. *The development of a retail market agenda*

#### a) Early developments

In pursuit of the EC Treaty objective of securing an internal market (Articles 3 and 14 EC) and in support of the Treaty free movement guarantees,<sup>27</sup> the Community institutions have long been engaged in the construction of an integrated financial market within which market actors can freely access liberalized cross-border markets.<sup>28</sup> Financial market integration is presumed to generate significant benefits in terms of choice, competition and easier access to capital and, ultimately, more

<sup>23</sup> The Commission, for example, has acknowledged that the policy debate 'assumes added importance' given the need to create the right conditions to support market-driven solutions for private retirement provisioning: European Commission, *Call for Evidence: Need for a Coherent Approach to Product Transparency and Distribution Requirements for 'Substitutive' Retail Investment Products* (2007), p. 21.

<sup>24</sup> FSA, *Finance in and at Retirement – Results of Our Review* (2007). Although the FSA did not find market failures, it highlighted difficulties concerning access to advice as well as widespread poor understanding of retirement and associated products and services.

<sup>25</sup> FSA, Press Release, 27 April 2009 (FSA/PN/055/2009). <sup>26</sup> SEC *Senior Report*.

<sup>27</sup> Particularly the freedom to provide services (Art. 49 EC), the freedom to establish (Art. 43 EC) and the free movement of capital (Art. 56 EC). Treaty references are to the EC Treaty, as the Treaty on the Functioning of the EU had not come into force at the time of writing (see Preface and acknowledgments).

<sup>28</sup> N. Moloney, *EC Securities Regulation* (2nd edn, Oxford: Oxford University Press, 2008), ch. 1.

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

liquid and efficient markets and stronger economic growth.<sup>29</sup> The legal technology used to achieve market integration<sup>30</sup> has been based on, first, the liberalization of market access through de-regulation (or the removal of Member States' ability to impose local regulatory requirements on cross-border actors) and, secondly, on the related re-regulation of those markets by a common harmonized rule base. Liberalization is achieved by the requirement for Member States to accept, or mutually recognize, the regulation (and often supervision) of cross-border actors by those actors' home Member States (typically the State where the actor has its head office); mutual recognition is supported by re-regulation or the harmonization of Member States' rules in order to remove the integration obstacles which protectionist or, more usually, diverging local rules represent, and to allow mutual trust between regulatory regimes. As part of this process of de-regulation, liberalization and re-regulation, the regulation of domestic financial markets has, over time, moved from the Member States to the EC and become a function of harmonized rules. But the Community's embrace of retail investor protection regulation and policy is a relatively recent phenomenon.

The seminal 1966 Segré Report, the opening salvo in what has since become a massive harmonized regulatory programme for financial services and markets, did not address retail investor protection in any detail.<sup>31</sup> The early phases of EC financial market regulation (from the late 1970s) were concerned with supply-side market access. Integration was initially sought through, first, detailed rule harmonization (best exemplified by the early securities directives (now repealed) which addressed capital-raising, disclosure and issuer access to cross-border markets) and, secondly, in the wake of the 1985 Commission White Paper on the Internal Market,<sup>32</sup> minimum harmonization (which allowed Member States to impose more stringent rules on their domestic actors and so accommodated some degree

<sup>29</sup> E.g. London Economics, *Quantification of the Macro-Economic Impact of Integration of EU Financial Markets: Final Report to the European Commission* (2002).

<sup>30</sup> Whether or not law can drive market integration and change actors' behaviour is a very large question. On the debate, see further Moloney, *EC Securities Regulation*, pp. 40–7 and, in the retail context, sect. II.3 below and ch. 2.

<sup>31</sup> Perhaps because at that time 'in continental Europe stockbrokers and other dealers are not organized in such a way as to facilitate contacts with the public at large. As for investment consultants, they are still far removed from the developed stage they have attained on the capital markets of some non-member countries': Report by a Group of Experts Appointed by the EEC Commission, *The Development of a European Capital Market* (1966) ('Segré Report'), p. 204.

<sup>32</sup> European Commission, *Completing the Internal Market* (COM (85) 310).

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

of regulatory competition) and mutual recognition (best exemplified by the 1985 UCITS Directive<sup>33</sup> on the UCITS CIS and the now-repealed 1993 Investment Services Directive (ISD) on investment services<sup>34</sup>). The ISD asserted in a recital reference that one of its objectives was to protect investors. But this assertion sat very uneasily in a Directive which was primarily focused on the investment firm, on the investment services passport and on achieving the minimum level of harmonization required to support home Member State control of cross-border investment firm activity. ISD harmonization was primarily directed to prudential and stability requirements; marketing and conduct-of-business regulation, touchstones for investor protection in the intermediation context, were not harmonized and were thus left to the control of host Member States.

The first significant moves towards a harmonized investor protection regime came in the late 1990s when market integration became more closely associated with the demand-side, the support of investor confidence as a means of encouraging integration<sup>35</sup> and, accordingly, the harmonization of investor protection rules. The first hint of an investor-facing approach came in 1996 when the Commission presented its Green Paper on Financial Services Consumers<sup>36</sup> which highlighted a number of investor protection concerns including aggressive marketing by investment firms and poor disclosure. A separate development outside the financial market policy sphere, the adoption of the 2000 E-Commerce Directive,<sup>37</sup> further sharpened the focus on investor protection. The Directive anchored cross-border e-commerce/online services (including online investment services) to the 'Member State of origin' (essentially the State of establishment) and removed the ability of host Member States to apply their protective rules to cross-border online services. The Directive's striking innovation was to remove host State control without parallel rule harmonization. By such accidents, or at least by a lack of joined-up

<sup>33</sup> Council Directive 85/611/EEC of 20 December 1985 on the co-ordination of laws, regulations and administration provisions relating to undertakings for collective investment in transferable securities, OJ 1985 No. L375/3.

<sup>34</sup> Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field, OJ 1993 No. L141/27.

<sup>35</sup> N. Moloney, 'Confidence and Competence: The Conundrum of EC Capital Markets Law' (2004) 4 *Journal of Corporate Law Studies* 1.

<sup>36</sup> European Commission, *Green Paper on Financial Services: Meeting Consumers' Expectations* (COM (96) 209).

<sup>37</sup> European Parliament and Council Directive 2000/31/EC of 8 June 2000 on certain legal aspects of information society services, in particular electronic commerce, in the single market, OJ 2000 No. L178/1.



Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

thinking across different Commission divisions, do major shifts in regulatory design occur. The subsequent 2001 Communication on E-Commerce and Financial Services<sup>38</sup> called for further convergence of protective rules, including conduct-of-business rules, in order to address the danger that Member States would rely on the E-Commerce Directive's derogations to the Member-State-of-origin principle to protect investors and consumers where the Member State of origin's rules were not regarded as offering adequate protection. But the Communication also adopted an investor-facing agenda. It linked market integration to the demand side and noted that 'consumer confidence' depended on sufficiently harmonized levels of protection. An initial response came in the form of the 2002 Distance Marketing of Financial Services Directive (DMD),<sup>39</sup> which addresses disclosure, marketing, contractual rights (including withdrawal rights) and redress in the distance marketing context and which applies to a range of financial services, including investment services. It was the EC's first sustained attempt to grapple with investor protection. It also reinforced the emerging reliance on 'confidence' as a demand-side justification for harmonization and market-integration measures; it argued that a high degree of consumer protection was required to enhance consumer confidence in distance selling (recital 3), and that a high level of consumer protection should be guaranteed by the Directive (recital 13).

#### b) The FSAP and the retail interest

Before the pivotal 1999 Financial Services Action Plan (FSAP),<sup>40</sup> a massive regulatory agenda which was designed to complete the integration of financial markets and remedy years of slow development, had begun to gather steam, the establishment of the Lamfalussy structures for EC law-making in the financial market sphere brought another influence to bear on the developing retail market agenda. The seminal 2001 Lamfalussy Report<sup>41</sup> was concerned with the establishment of a new EC law-making mechanism for delegated law-making (which empowers the Commission

<sup>38</sup> European Commission, *Communication on E-Commerce and Financial Services* (COM (2001) 66).

<sup>39</sup> European Parliament and Council Directive 2002/65/EC of 23 September 2002 concerning the distance marketing of consumer financial services and amending Council Directive 90/619/EEC and Directives 97/7/EC and 98/27/EC, OJ 2002 No. L271/16 ('Distance Marketing Directive' or DMD).

<sup>40</sup> European Commission, *Communication on Implementing the Framework for Financial Markets: Action Plan* (COM (1999) 232) (FSAP).

<sup>41</sup> *Final Report of the Committee of Wise Men on the Regulation of European Securities Markets* (2001) ('Lamfalussy Report').



Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

to adopt delegated rules, advised by the Committee of European Securities Regulators (CESR, composed of Member State regulators) and supervised by the European Securities Committee (ESC, composed of Member State representatives)).<sup>42</sup> Financial market rules now take the form of 'level 1' measures (typically directives) adopted by the institutions under traditional Treaty law-making procedures, detailed 'level 2' rules adopted by the Commission and 'level 3' guidance adopted by CESR.<sup>43</sup> But the Lamfalussy Report also prioritized retail investor protection. It highlighted the absence of 'high and equivalent levels of consumer protection and no efficient methods for resolving cross-border consumer disputes' and recommended that 'the conceptual framework of overarching principles', on which, it suggested, all EC financial market regulation should be based, include a commitment to ensuring 'appropriate levels of consumer protection proportionate to the different degrees of risk involved'.<sup>44</sup> Its lasting legacy to the retail market agenda, however, was the establishment of CESR, which has had a far-reaching influence on the EC retail market agenda.<sup>45</sup>

The explosive combination of the Lamfalussy law-making reforms and the FSAP regulatory reform agenda led to an exponential increase in the intensity of EC financial market regulation over the FSAP period (1999–2004). The FSAP also included a discrete retail market agenda<sup>46</sup> and the retail market interest emerged strongly across a series of FSAP measures. The first indications of the adoption of a retail market agenda came with the 2003 Prospectus Directive.<sup>47</sup> While designed to support cross-border capital-raising by issuers (by harmonizing prospectus requirements and clarifying the scope of private placements), it is also designed to build the confidence of 'small investors' in financial markets (recital 41) and has a strong retail orientation;<sup>48</sup> recital 16 states that 'one of the objectives of this Directive is to protect investors'.<sup>49</sup> The most dramatic

<sup>42</sup> See further ch. 7. <sup>43</sup> *Ibid.*

<sup>44</sup> *Lamfalussy Report*, pp. 12 and 22. <sup>45</sup> See further ch. 7.

<sup>46</sup> 'Appropriate and progressive harmonization of marketing and information rules throughout the Union together with a pragmatic search for non-legislative solutions offers the prospect of a truly integrated retail market fully respecting the interests of consumers and suppliers': FSAP, p. 10.

<sup>47</sup> Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC, OJ 2003 No. L345/64 ('Prospectus Directive').

<sup>48</sup> The European Commission's advisory European Securities Market Expert Group has described the principal objective of the Prospectus Directive as to protect the retail investor: ESME, *Report on Directive 2003/71* (2007), p. 10. See further ch. 6.

<sup>49</sup> But investor protection runs across the Directive. E.g. recitals 10, 18, 19, 20 and 21.

Cambridge University Press

978-0-521-88870-7 - How to Protect Investors: Lessons from the EC and the UK

Niamh Moloney

Excerpt

[More information](#)

developments, however, occurred with MiFID.<sup>50</sup> The massive MiFID regime, discussed throughout this book, is expressly designed to support investor protection (e.g. recital 31)<sup>51</sup> and addresses conduct-of-business regulation (including marketing, disclosure and suitability requirements), best execution, conflict-of-interest management and order execution and market transparency. MiFID is also notable for the Commission's related regulatory rhetoric which claims investor protection (domestically and cross-border) as a legitimate concern of EC financial market regulation<sup>52</sup> and which appears to break the link between investor-protection-based harmonization and market integration;<sup>53</sup> under MiFID, investor protection has become an end in itself. The MiFID Proposal was designed to address the failure of the precursor ISD to provide a 'bedrock of harmonized investor protection',<sup>54</sup> while the pivotal conduct-of-business regime was described as a 'mainstay of investor protection'.<sup>55</sup> In one of the more striking of MiFID's many retail market innovations, the regulation of investment advice has now become a function of EC law (chapter 4). But

<sup>50</sup> It has been described as 'the most significant directive in capital markets law of recent times': BaFIN, *Annual Report 2007–2008*, p. 12.

<sup>51</sup> The FSA has described MiFID in investor protection terms: 'One of the main objectives of MiFID is to provide a high level of investor protection': *Reforming Conduct of Business Regulation* (Consultation Paper No. 06/19, 2006), p. 9.

<sup>52</sup> 'There is a need for enlightened regulation to define the rules of the game and for strong policemen to enforce these rules... [MiFID] should equip regulators with a comprehensive set of regulatory disciplines to tackle the risks to which the modern retail investor is exposed... A high level of protection is crucial *in its own right* [emphasis added]. It is also a pre-condition for the effective operation of the ISD passport': Speech by Director-General Schaub of the Internal Market Directorate General on 'Economic and Regulatory Background to the Commission Proposal for Revision of the ISD', 15 October 2002, available via <http://europa.eu/rapid/searchAction.do>.

<sup>53</sup> All EC legislative measures must meet subsidiarity and proportionality requirements and be based on a Treaty competence (Art. 5 EC). In the financial markets sphere, harmonization has typically been based in the free-movement- and barrier-removal-related competences set out in Art. 44(2)(g) EC (directives designed to co-ordinate the safeguards required by Member States of companies or firms for the protection of members and others), Art. 47(2) EC and Art. 55 EC (directives designed to co-ordinate Member States' rules on the taking up and pursuit of activities as self-employed persons) and in the two general single market competences, Art. 94 EC (directives for the approximation of Member States' rules which directly affect the establishment or functioning of the common market) and Art. 95 EC (measures for the approximation of Member States' rules which have as their object the establishment and functioning of the internal market). The EC institutions do not enjoy a general power to regulate the internal market. Internal market measures must be based on the need to remove regulatory barriers or distortions to competition, although the Commission has rarely appeared troubled by this restriction: Moloney, 'Confidence and Competence'.

<sup>54</sup> European Commission, *MiFID Proposal* (COM (2002) 625), p. 23. <sup>55</sup> *Ibid.*, p. 25.