

Transition period

The Czech and Slovak Republics are dealing differently with MiFID implementation, and Czech lags behind. Still it will bring benefits, says Zdenek Hustak of Brzobohaty Broz & Honsa

The new regime for the provision of investment services and organising markets with the financial instruments introduced by MiFID undoubtedly represents a major change to the way the European financial market infrastructure has worked over the past 15 years. This new legal framework consists of three extensive pieces of legislation – the framework Directive and two implementation measures, the Implementation Directive and the Implementation Regulation. It was created as a part of a broader action plan for financial services launched by the European Commission some nine years ago. The Implementation Directive and the Regulation of the European Parliament and the Council (August 10 2006) govern record-keeping obligations of investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and define the purpose of the Directive. These legislative texts were elaborated using a specific Lamfalussy procedure, which also provides for the development of interpretative standards by the college of EU member states' capital markets regulators (CESR), designed to provide guidance for its members and facilitate harmonised implementation and application of these directives and regulations.

The issues covered by MiFID include the extending of the regulatory regime to new types of financial instruments, such as commodities and other types of derivatives. Also among the regulated services are the providing of investment advice and the operation of multilateral trading facilities (MTFs). Substantial modifications were made to the organisational requirements for investment firms stressing the importance of outsourcing arrangements and conflict of interest management. What has been altered most is the structure of business rules. These are detailed, compared with the scope of the relevant provisions of the Investment

Services Directive of 1993. The new structure of the business rules focuses on the enhancement of investor protection, obliging investment firms to provide their clients with well-structured information and warnings. Stricter rules for providing investment advice and asset management also apply. Firms providing trade services to clients will have to introduce new policies for client-order handling and detailed best execution rules. Detailed provisions now apply to systematic internalisation, which represents a specific form of trading service in which the investment firm acts as a market developer providing firm quotes to its clients.

As regards distribution networks, the new European laws outline the clear responsibilities of investment firms using tied agents for soliciting business and distributing their services. There are certain exemptions for the distribution of securities and units of collective investment undertakings in the MiFID harmonised regime – these are left to the member states' discretion.

The rules governing market infrastructure have been changed as well. The new concept of the trading platform is recognised by MiFID, introducing the MTFs, which are to be an alternative to the traditional exchanges. Of course, exchanges may be relabelled as regulated markets. There are

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new requirements on the rules that are to be passed by regulated market organisers and on internal procedures, trading and monitoring systems operated by market organisers. Following the increase in the number and diversity of trading venues, MiFID introduces the new idea that the transparency of market data had been stipulated for. The so-called pre-trade transparency obliges all trading platforms to publish data on the demand and offer for shares admitted to trading on regulated markets. Post-trade transparency requires disclosure of data on trades concluded on a particular trading venue.

For securities to be traded on a regulated market, a specific listing regime emerged – the MiFID requirements being somewhat parallel to the rules prescribed by the Listing Directive of 2001. From now on, the standards set by the Listing Directive, which are more detailed and often stricter than MiFID rules, will apply to securities listed on specific segments of a regulated market (official market). All other securities listed on such regulated market will have to comply with the relatively more relaxed MiFID rules.

The passporting agenda, as prescribed in MiFID, is distinct. The new regime not only enhances the passport regime of investment firms but also introduces passports for regulated markets. Powers of home states' regulators are extended. Host states' regulators are reduced in some cases, with a host member state's regulator being allowed to act only after the home state's regulator failed to stop the wrongdoing. From this particular feature of the new regime, the growing importance of cooperation and exchange of information among national regulators is evident. Last but not least, MiFID endorses the establishment of national courts to create systems to facilitate dispute resolution among investment firms and their clients.

Transposition of MiFID

Although developments in the financial markets of the Czech and Slovak Republics have followed similar tracks, the structures of the markets are different, given their differing size and number of players. The approaches taken by each country in implementing the latest European rules for financial markets have also diverged. Deadlines for the transposition of MiFID rules by EU member states expired last year in January. As of last November, the MiFID regime was supposed to be effective throughout the EU.

The Slovak Republic transposed MiFID last spring, significantly amending the

Securities and Investment Services Act (Slovak Act 566/2001 Coll on Securities and Investment Services) and choosing the copy-out style when particular provisions of the Act clearly followed the text of MiFID and the Implementation Directive. This Act governs the authorisation of investment firms and provision of investment services, including systematic internalisation and related transparency requirements. The Securities and Investment Services Act also regulates investment intermediaries that are otherwise exempt from the MiFID regime. Amendments levelling up the rules applicable to investment intermediaries to MiFID standards were also introduced.

Certain changes were also projected in the Stock Exchange Act (Slovak Act Coll on Collective Investment), which brought in new rules for regulated markets, rules for members and participants in a market, authorisation of the MTF and pre-trade and post-trade transparency requirements. Minor amendments of the Collective Investment Act reflected that Management Companies (Slovak Act 594/2003 Coll on Collective Investment) can be authorised to provide investment services as well. Secondary legislation completing MiFID transposition in the Slovak Republic is represented by regulations issued by the Slovak National Bank. These regulations set detailed rules governing the provision of information to clients by an investment firm.

The national law also provides for a transitional period for firms and markets to adapt to the new rules. This transition period goes beyond the official MiFID implementation date expiring in May 2008.

In contrast with the Slovak Republic, the Czech Republic has still not fulfilled its obligation as an EU member and the transposition of the MiFID directives has not yet been completed. This was the cause of the European Commission starting infringement proceeding against the Czech Republic in January of this year. The bill transposing MiFID is being discussed in the Czech Parliament. It is expected that relevant Czech law will be approved during this summer.

The approach to the transposition taken in the Czech Republic differed from that of the Slovak Republic. The Ministry of Finance undertook several rounds of public consultation to achieve a more organic implementation of the MiFID rules into the national legal system. Most of the changes brought by MiFID will be reflected in the Capital Markets Undertaking Act (CMUA, Czech Act 256/2004 Coll Capital Markets Act). This Act governs the authorisation of investment firms, prudential rules and conduct of business rules. Like the Slovak

Author biographies



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As counsel at BBH, Zdeněk Husták focuses on financial services and regulatory issues and is responsible for professional legal support for clients' projects in the areas of capital markets and banking (for example, MiFID implementation projects, issues of corporate bonds and listing, collective investment and Isda contracts), including knowledge management and know-how development and representing the firm at the Czech Capital Market Association.

Husták joined the firm after a career that culminated in being advisor to the Deputy Finance Minister at the Ministry of Finance of the Czech Republic, this being preceded by a career with the Czech Securities Commission, where he was a member of the Presidium. This meant managing a staff of 50 overseeing the supervision and regulation of investment services, regulated markets and clearing and settlement systems, the coordination of the risk-based regulatory system and representation of the CzSec at meetings of Ccsr and Iosco. Concurrently, Husták was vice-chairman of the board of the Investor Compensation Scheme (the ICS).

Zdeněk Husták joined BBH in 2007. A student at the Masaryk University of Brno, Czech Republic, Zdeněk earned masters degrees in finance and financial and commercial law and is pursuing his masters degree in theoretical legal studies in commercial law and is a frequent publisher of articles in the Czech and foreign legal and economic press, as well as a speaker and trainer in a number of domestic and foreign conferences and seminars. Husták speaks Czech, English, Russian, German and French.

Act on Securities, the Czech CMUA establishes investment intermediaries as a category exempt from the MiFID regime. Newly proposed rules for the investment intermediaries' compliance with business rules are in practice. They are the same as the MiFID conduct of business rules, leaving only the organisational requirements of the investment intermediaries to remain nationally specific. There are minor amendments to the Act on Capital Markets Supervision (Czech Act 15/1998 Coll on Supervision in the Area of Capital Markets) implementing new powers for the Czech National Bank, which supervises the Capital

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Markets in the Czech Republic and broadens areas of regulatory cooperation and information exchange. Similarly, in Slovakia, the amendment to the Act on Collective Investments (Czech Act 189/2004 Coll Sb on Collective Investment) modifies the rules for management companies providing investment services.

A significant part of the MiFID transposition in the Czech Republic should be reflected in the decrees being prepared by the Czech National Bank. The crucial decree stipulates detailed rules on the organisation and conduct of the business of investment firms and investment intermediaries, which transposes most of the Implementing Directive. The decree also contains detailed rules on internal control systems and risk management for investment firms as imposed by the Capital Requirements Directive.

As in Slovakia, in the Czech Republic the bill proposes a transition period of nine months, which extends well beyond the end of 2008. This may be welcomed by local firms but it is highly questionable in light of the infringement proceeding already initiated.

Challenges for firms

Given the short and turbulent history of the financial markets in the Czech and Slovak Republics, it is appropriate to comment that often local market developments were caused not by an initiative of the market itself, but either by administrative decisions or new

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legislation being imposed. Transposition of European legislation has often meant a large number of new rules bringing real novelties to local regulators and market participants. A certain amount of time is needed for an understanding of the rules’ meaning to be gained, since the rules may have originated in a completely different environment to that of the transition or post-transition economy. The financial markets in both countries evolved, and they lag only slightly behind the latest developments in old EU member states. The challenges firms in both countries face are similar to those faced by firms elsewhere in the EU.

Of course, MiFID has brought in several entirely new concepts that were unfamiliar in both the Czech and Slovak markets. Apart from the new trading platforms like MTFs and systematic internalisation (which seems not to be of serious business interest to firms in either country), the regulation of investment advice and the strict requirements and rules of conduct imposed on advisers is the firms’ focus. The framework for investment advisory services is a benefit of the new regime.

The concept of client categorisation is also new to local firms. The introduction of practically three different sets of rules, on one hand providing flexibility in trading with eligible counterparties and on the other, detailed rules protecting retail clients, impose more demands on firms’ resources and force firms to alter their business models. The MiFID rules on testing the suitability and appropriateness of investment services and products on offer to clients are increasing the amount of data collected and processed by the firms and imposing more pressure on the level of skill and competence possessed by sales staff and investment advisers.

One specific issue is the best execution requirements, which divide investment firms into two tiers – the first group being firms trading only on one trading venue, the second, firms with access to different trading

venues. For the first group, the implementation of the best execution rules is straightforward, but the other group must adopt more complex solutions.

As mentioned above, both the Czech and Slovak laws transposing MiFID also regulate investment intermediaries that are exempt from the MiFID regime. There are significant changes to the requirements imposed on the distribution platforms. In contrast with the current light-touch environment, the new conduct of business rules propose to apply all of the MiFID conduct of business rules applicable to the investment services provided by investment intermediaries – that is, to the receipt and transmission of clients’ orders and investment advice. Most of the distribution platforms will need to make major alterations to their business models to comply with the new regime. Also, the updated standards imposed on the internal control systems of the operators of the distribution platforms will require more robust internal procedures and enhanced support of the IT systems to ensure compliance with the rules by the distribution network. The training of sales teams and those advising within these distribution networks will surely be more resource intensive than in investment firms.

Modifications to internal processes and IT systems underlie the intricacy of the MiFID regime and represent most of the compliance costs incurred by firms. The survey and updating of all the outsourcing arrangements may demand time and communication as well. The drafting and implementation of the conflict of interest policies will affect leading investment firms active in investment research and corporate finance areas.

MiFID implementation

As both countries are introducing transition periods for the new laws and, because the Czech Republic lags behind in its MiFID transposition, the current state of investment firms’ MiFID compliance varies. Some firms, particularly large banks or broker-dealers that are part international groups, are progressing with the MiFID implementation projects, thanks to the groups centralised by the MiFID initiatives. Sometimes, incentives to achieve MiFID compliance swiftly were induced by foreign investors wishing their Czech or Slovak counterparty to place orders with a MiFID-compliant firm. Most midsize and small investment firms are at the beginning of their MiFID implementation.

Practical experience shows that most Czech and Slovak investment firms consider MiFID to be an administrative and

compliance exercise. They intend to conduct their MiFID implementation projects internally or employ consultancy or law firms for limited parts of their projects.

MiFID and clients

As firms gradually implement MiFID requirements, they start communicating the practical implication to their clients. As the expiry of the transition period approaches in the Slovak Republic in May, more firms will publish information on the MiFID agenda on their websites and update documents for clients, such as required statutory information and disclaimers. Most of the Czech firms are postponing informing their clients and conducting client categorisation and related exercises until the new law is issued and effective. This is because they do not want to make the first move, asking clients more questions and requiring them to sign more paperwork than their competitors. Some firms also question the usefulness of providing complex information to clients given the current level of their financial literacy and their ability to make informed investment decisions.

In some ways investors are in a similar position. They will only begin to be aware of the information provided to them and their rights and obligations under the new regime after gaining experience. It is a general expectation on both markets that as there are more elaborate rules designed to protect retail investors and more of those clients become aware of their rights, clients may enter into more disputes with their investment firms. With this possibility in mind, it is inconvenient for both firms and clients that no officially recognised out-of-court redress system exists in Slovakia or in the Czech Republic, despite the efforts of some trade associations.

The new European regime for the financial markets established by the MiFID and its implementing measures represents a challenge for the firms and markets of all EU member states. For new EU members’ markets, some of these new concepts will require a certain amount of time to be fully implemented – obviously longer than the transition period provided by the MiFID. The approach to the MiFID transposition by member states may differ, as shown by the examples of the Czech and Slovak Republics. Experience with the level of MiFID compliance and implementation efforts at firms will also vary depending on whether a firm belongs to an international financial group or not. For firms in the Czech Republic and in Slovakia, the new regime makes only a limited contribution to the market development, but the framework for investment advice that it brings is a



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