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Abstract

The European Directive on Markets in Financial Instruments and its implementing Directive impose on investment firms among others rules of conduct that have to be respected when providing investment services to their clients. The aim of these rules is to preserve the investors' interests. Several of these rules of conduct create the obligation for the investment firm to provide the investor with information as well as the obligation to obtain information from the investor. The aim of this paper is to discuss and evaluate these information requirements. More specifically, the article aims at investigating whether these rules will be effective in protecting private investors.

Protecting investors through information requirements

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The European Directive on Markets in Financial Instruments and its implementing Directive impose on investment firms among others rules of conduct that have to be respected when providing investment services to their clients. The aim of these rules is to preserve the investors' interests. Several of these rules of conduct create the obligation for the investment firm to provide the investor with information as well as the obligation to obtain information from the investor. The aim of this paper is to discuss and evaluate these information requirements. More specifically, the article aims at investigating whether these rules will be effective in protecting private investors.

1. Introduction

The European Directive on Markets in Financial Instruments (hereafter MiFID) (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, *O.J.* L. 30 April 2004, 145/1) and its implementing Directive (hereafter Implementing Directive) (Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organizational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive, *O.J.* L. 2 September 2006, 241/26) provide harmonized regulation for investment services across the 30 member states of the European Economic Area. The main objectives are to increase competition and consumer protection in investment services.

MiFID replaces (since 2007, November 1st) the Investment Services Directive (ISD). The adaptation of the European legislation on investment services had become necessary since more investors became active in the financial markets and investors were offered an even more complex wide-ranging set of services and instruments. On one hand, MiFID aims to allow investment firms to provide services throughout the Community, being a Single Market, on the basis of home country supervision. On other hand, it aims to increase investor's protection by imposing on investment firms detailed rules of conduct that have to be respected when providing investment services to their clients. The basic rule of conduct is laid down in article 19 MiFID which determines that an investment firm must always act honestly, fairly and professionally in accordance with the best interests of its clients.

Several of the rules of conduct create the obligation for the investment firm to provide the investor with information as well as the obligation to obtain information from the investor. The main idea behind these rules is that an investor will only be able to make an informed decision when he has been clearly informed about the services offered (and their risks) and that an investment firm can only provide investment services in accordance with the clients' best interests when it knows what kind of customer it is dealing with. The aim of this paper is to discuss and evaluate these information requirements which vary depending on the category of investors to whom investment services are provided and depending on the kind of investment services that are being provided. More specifically, it aims at investigating whether these rules will be effective in protecting private investors.

2. Scope of application

The rules of conduct have to be respected by investment firms, i.e. any legal person whose regular occupation or business is the provision of one or more investment services to third parties and/or the performance of one or more investment activities on a professional basis (art. 4, 1 MiFID). Can be classified as investment services : the reception and transmission of orders in relation to one or more financial instruments, the execution of orders on behalf of clients, portfolio management and investment advice (Annex I, Section A MiFID).

2.1 Portfolio management and investment advice

It is interesting to have a closer look at the concepts of portfolio management and investment advice, especially because in case of portfolio management and investment advice the investment firm will have the obligation to obtain more information.

2.1.1 Portfolio management

'Portfolio management' means managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments (art. 4, 9 MiFID). Essential to portfolio management is that the manager will be able to sell or buy financial instruments on behalf of its client without the need of prior approval from the client. The client only gives a general mandate.

2.1.2 Investment advice

'Investment advice' means the provision of personal recommendations to a client, either upon its request or at the initiative of the investment firm, in respect of one or more transactions relating to financial instruments (art. 4, 4 MiFID). The distinction between portfolio management and investment advice is clear. In case of investment advice the investment firm only gives a recommendation to buy or sell a financial instrument, the investment adviser not being entitled to actually perform the transaction. Therefore the investment adviser will only be able to carry out the transaction if a separate mandate in that respect is given by the client.

Investment advice requires a personal recommendation. A recommendation is considered to be a personal recommendation when it is presented as suitable for that person, or it is based on a consideration of the circumstances of that person. Therefore, a recommendation which is issued exclusively through distribution channels or to the public cannot constitute investment advice. Further the investment advice must consist of a recommendation to buy, sell, subscribe for, exchange, redeem, hold or underwrite a particular financial instrument or to exercise or not to exercise any right conferred by a particular financial instrument to buy, sell, subscribe for, exchange, or redeem a financial instrument (art. 52 implementing Directive). This implies that generic advice (e.g. the statement that it is a good time to buy shares) does not constitute investment advice (Avgouleas 2004), which implies that the - for the investment firm costly - suitability obligation to gather information is deferred until the recommendation becomes specific (Moloney, 2007).

Apart from that it is irrelevant whether the advice is given at the clients' request or at the investment firm's own initiative. It is also not necessary that a formal (written) agreement is concluded. Finally, it is not necessary that a remuneration is paid for the advice.

In deciding whether a recommendation can be considered as a personalized recommendation one has to take into account the perception an investor reasonably might have (Lannoy, 2007). More specifically, one has to investigate whether an average client, on the basis of the same conversation, would have had the impression that the recommendation was based on a consideration of his personal circumstances. An investment firm that wishes to avoid that a certain recommendation is considered investment advice, has to inform the client explicitly that it does not want to give a personal recommendation, i.e. a recommendation that is suitable for that person, or is based on a consideration of the circumstances of that person.

The mere fact that the statement mentions that no advice has been given is not decisive. One has to find out what happened in reality. Moreover, if what is mentioned on the statement does not truly reflect reality, the investment firm acts in contravention with article 19 MiFID that determines that investment firms must always act honestly, fairly and professionally in accordance with the best interests of its clients. However if the statement mentions that no advice has been given it will be very hard to the investor to prove that in reality a recommendation has been given that was presented as suitable for him or based on his personal circumstances.

2.2 Categorization of clients

With respect to the investor, a distinction is made between three categories of clients : the retail client, the professional client and the eligible counterparty. The distinction between these categories of clients is important since the extent to which the rules of conduct have to be followed, and therefore the degree of protection offered, differs between these categories of investors (Van der Haegen, 2004). An eligible counterparty will get the least protection, the retail client the most extensive protection (Pan, 2007-2008).

The client must be informed by the investment firm about the category to which he belongs (art. 28.1 implementing Directive) (Pan, 2007-2008).

The retail client is a client who is not a professional client (art. 4, 12 MiFID). Therefore in order to find out which investors can be considered as retail clients we have to determine who can be considered a professional client. A professional client is a client who possesses the experience, knowledge and expertise to make his own investment decisions and to properly assess the risks he incurs. More specifically, in order to be considered a professional the client must fall into one of the categories, listed in Section I of Annex II MiFID. It concerns for example credit institutions, investment firms, insurance companies, collective investment schemes, pension funds, large undertakings meeting several requirements, national and regional governments, public bodies that manage public debt, Central Banks, international and supranational institutions such as the World Bank, the IMF, the ECB, the IB and other similar international organizations and other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitization of assets or other financing transactions. When having a closer look at the list of professional clients, it becomes clear that the concept of a retail client is broader than the traditional concept of a consumer. European Directives aiming at protecting the consumer generally define the consumer as a physical person acting for purposes which are outside his trade, profession or business.

Professional clients may ask the investment firm to be treated as a retail client (opt down). Retail clients, including individuals may ask the investment firm to be treated as a professional client, at least if certain conditions are met, (opt up) (Van der Haegen, 2004). Opting up might be interesting for some retail clients since professional clients have access to products and services that are not available to retail clients (e.g. more complex products). Therefore, opting up will enlarge their choice.

Having a closer look at the criteria which must be met to be able to treat a retail client as a professional client, a distinction can be made between qualitative, quantitative and procedural requirements. The qualitative criterion requires the investment firm to make an adequate assessment of the expertise, experience and knowledge of the client. Only if the assessment gives the investment firm reasonable assurance, in light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and understanding the risks involved, the investment firm may treat the retail client as a professional client. Looking at the quantitative criteria it is clear that most retail clients that are consumers in the traditional meaning of the word will not meet the quantitative criteria. But even if they do meet these criteria investment firms might not be eager to treat the retail client as a professional client because they might be afraid that afterwards, when their liability is challenged, a judge will decide they did not make an adequate assessment of the clients experience and knowledge.

3. Information in advertising

All information, including marketing communications, that investment firms address to their clients and potential clients or that investment firms disseminate in such a way that it is likely to be received by retail clients or potential retail clients, must meet several criteria. First the information must be accurate, fair, clear and not misleading. Marketing communications must be clearly identifiable as such (art. 19 MiFID). It must be sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received (art. 27, 2 implementing Directive). It is clear that advertising must be assessed taking into account the so called average “investor” within the group to which the information is addressed, a criterion which is also used in the Directive on unfair commercial practices. This is a challenging requirement for investment firms, given the different capabilities of investors. The new rule must ensure that marketing of complex and risky products is not inappropriately targeted to vulnerable investors (Moloney, 2007).

These general rules do not add too much to the rules incorporated in the Directive on unfair commercial practices. The added value lies in the fact that the general rule is made more specific by giving examples of prohibited commercial communication in the Implementing Directive. These requirements are specifically targeted to retail investors, given their greater vulnerability and limited ability to bargain for disclosure and the material effects marketing communications have on investor decisions (Moloney, 2007). It is interesting to provide a few examples to illustrate this. Marketing communications may not emphasize any potential benefits of an investment service or financial instrument without also giving a fair and prominent indication of any relevant risks. They may not disguise, diminish or obscure important items, statements or warnings. Where advertisements contain an indication of a past performance of a financial instrument, a financial index or an investment service, several conditions must be satisfied, including that the indication must not be the most prominent feature of the communication, the information must include appropriate performance information which covers in principle the immediately preceding 5 years and must contain a prominent warning that the figures refer to the past and that past performance is not a reliable indicator of future results. Where advertising contains information on future performance, it must, among other, be based on reasonable assumptions supported by objective data and contain a prominent warning that such forecasts are not a reliable indicator of future performance.

More interesting than elaborating these rules into detail is the question whether a violation of these rules might also constitute an infraction of the rules on unfair commercial practices. The answer to this question is clearly yes, as far as the advertising is addressed to consumers (the Directive on unfair commercial practices only protects consumers). In order to support this view reference can be made to article 7 of the Directive on unfair commercial practices, which relates to the prohibition to mislead consumers by omission of essential information and which explicitly states that a commercial practice is misleading if, in its factual context, taking account all its features and circumstances and the limitations of the communication medium, it omits *material information* that the average consumer needs, according to the context, to take an informed transactional decision and thereby causes or is likely to cause the average consumer to take a transactional decision that he would not have taken otherwise. According to article 7.5 and annex II of the Directive on unfair commercial practices, information requirements established by article 19 of Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments must be regarded as material.

More in general one can argue that advertisements violating article 27 of the implementing Directive will be contrary to the prohibition of misleading commercial practices, since in most cases these violations will cause or will be likely to cause a consumer to take a transactional decision that he would not have taken otherwise. In Belgium this implies that the sanction which is incorporated in article 41 of the Act on Market Practices can be applied. This article determines that in case an agreement has been concluded *following* (due to) an unfair commercial practice, a judge can - in some (however for investments not relevant) cases he even must - decide that the sums a consumer has already paid need to be refunded to the consumer, who does not have to return the goods received or the services performed. The use of the word “can” illustrates that the judge has a great discretionary power. He can apply this sanction, but he does not have to do so. Also and even more important, this sanction does not enable the judge to decide that the investment firm has to bear all the losses which result from the investment following the misleading advertising. On the contrary, the judge can only decide that the investment firm has to return to the consumer the sums paid by him as a remuneration for the investment services. If the consumer wants to recover the losses incurred he will have to invoke general principles of civil law, implying that he will have to prove that the losses he suffered were due to the violation of the rules on commercial communications, laid down in article 27 of the Implementing Directive.

4. Obligation to provide information

4.1 In general

According to article 19.3 MiFID the investment firm must provide to their clients or potential clients appropriate information in a comprehensible form about : (1) the investment firm and its services (2) the methods of communication to be used between the investment firm and the client; (3) financial instruments and proposed investment strategies (this must include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies), (4) execution venues, and (5) costs and associated charges, for example: the total price to be paid by the client in connection with the financial instrument or the investment service or ancillary service, including all related fees, commissions, charges and expenses, and all taxes payable via the investment firm or, if an exact price cannot be indicated, the basis for the calculation of the total price so that the client can verify it.

The information must be provided in a way that clients or potential clients are reasonably able to understand the nature and risks of the investment service and of the specific type of financial instrument that is being offered and, consequently, to take investment decisions on an informed basis. The obligation to provide information is further elaborated in the articles 29 – 33 of the Implementing Directive which not only determine very precisely which information has to be provided, but also when and in which form the information has to be given.

4.2 Content of the information

The implementing Directive enumerates the information that has to be provided to clients and potential clients. The information which has to be given is very extensive. The fact that the Directive precisely determines which information must be provided implies that the obligation to provide the enumerated information must be seen as an ‘obligation of results’ (delivery commitment or obligation to achieve a result). At least in Belgium this means that the mere violation of this obligation to provide the enumerated information constitutes a fault which will lead to liability in case a client suffers damages by it.

Article 19 MifID determines that the information required may be provided in a standardized format. The question arises whether this implies that the same information can be given to every client. We don't think so, since article 19 MiFID also requires that the information is fair and clear. What is clear for one person, for example a company director, will not necessarily be clear to another person, for example a low-skilled worker. If an investment firm deals with a potential client with limited education and limited knowledge concerning financial instruments, it must ensure that the standardized information provided, especially the information relating to the risks involved, can be understood by this subcategory of less educated and less experienced investors. Therefore, if the investment firm does not want to communicate information to every potential client which is that easy to understand that it can be understood by the less experienced investor, it will have to use different standardized information forms, adapted to the different subcategories existing within the category of retail clients.

Against this reasoning one might argue that an investment firm has fulfilled its obligation to provide information properly when the information is understandable for the average retail client. As already indicated article 27.2 of the implementing Directive determines that it is sufficient that the information is likely to be understood by the average member of the group to whom it is directed. However this argument is not valid. Article 27 also applies to commercial communications, i.e. advertising. It is clear that this rule only requiring that the information is understandable for the average retail client is intended for situations where information is directed to several people at the same time. This rule does not apply where an investment firm must provide the information required by the implementing Directive to a specific retail client in the context of conclusion of the agreement (infra), the goal of this information requirement being to enable that specific retail client to make an informed investment decision. Contrary to what happens in case of advertising, the investment firm will or at least should know what type of retail client it is dealing with.

4.3 Point in time on which the information must be provided

With regard to the point in time on which the information has to be provided a distinction must be made between on one hand the obligation to provide the contractual terms, conditions and information of the investment firm and on other hand the obligation to provide information on the nature and risks of the financial instruments and on the costs and associated charges. Whereas the first must be provided in due time before a retail client or potential retail client is bound by any agreement on the provision of investment services or ancillary services (or before the provision of those services, if the service is being performed before the consumer is bound by the contract), the latter can be provided in due time before the provision of investment services or ancillary services (art. 29 implementing Directive). Therefore, information on the nature and risks of the financial instruments and on the costs and associated charges can be provided after the conclusion of the agreement (as this is a framework contract).

The distinction between these two categories of information is logical since at the time of conclusion of the framework agreement it is impossible to provide information on the nature and risks of financial instruments and on the costs and associated charges with regard to transactions that will be performed in the future. In any event the information must be provided in good time before the provision of investment services, meaning it must be provided at a moment where it can be taking into account by the investor before he decides. In assessing whether the information was provided in due time one must take into account the urgency of the matter and the time the client needs to absolve the information and respond to it (Colaert en Van Dyck, 2008).

In some situations it is permitted that the information is provided immediately after the client is bound by any agreement for the provision of investment services or ancillary services or immediately after starting to provide the service. This will be the case if, at the request of the client, the agreement was concluded using a means of distance communication which prevents the firm from providing the information in good time before the conclusion of the agreement or provision of the service (art. 29.5 implementing Directive). This rule for example relates to the situation where the contract is concluded over the phone (Berard, 2007). In a case like this the investment firm, dealing with a retail client has to comply with the information requirements laid down in article 3.3 of the Directive on distance marketing of consumer financial services which contains a list of information that has to be provided in case of voice telephony communications. It is important to stress that, although the Directive on distance marketing of consumer financial services only applies to consumers, the investment firm will have to comply with it whenever it deals with a retail client, even when it is not a consumer.

4.4 How the information must be communicated

The information must in principle be provided in a durable medium (art. 29.4 implementing Directive). The term “durable medium” means any instrument which enables a client to store information addressed personally to that client in a way accessible for future reference for a period of time adequate for the purposes of the information and which allows the unchanged reproduction of the information stored (art. 2.2 implementing Directive). It is clear that the concept of durable medium not only refers to paper documents. More specifically a DVD, a CD-ROM and the hard drive of the consumer's computer on which the electronic mail is stored can be regarded as durable media.

Nevertheless the information must in principle be provided on paper, since a durable medium, other than paper, can only be used if certain conditions are met. First, the provision of the information in this medium must be appropriate to the context in which the business between the firm and the client is, or is to be, carried on (art. 3.1 implementing Directive). According to article 3.3 of the implementing Directive the provision of information by means of electronic communications is appropriate to the context in which the business between the firm and the client is, or is to be, carried on if there is evidence that the client has regular access to the internet. The provision by the client of an e-mail address for the purposes of carrying on that business constitutes such evidence. It is to be expected that in most cases this condition will be met, since a retail client today will normally provide his e-mail address when concluding an agreement with the investment firm (Colaert en Van Dyck, 2008). However there is a second requirement, which in practice will be more important: the person to whom the information is to be provided, must, when offered the choice between information on paper or in that other durable medium, specifically choose the use of the other medium (art. 3.1 implementing Directive).

Although a website normally cannot be regarded as a durable medium, article 29.4 of the implementing Directive makes it possible to provide the information required by means of a website, at least if certain condition are met. More specifically, article 3.2 of the implementing Directive requires that: (1) the provision of that information in that medium is appropriate to the context in which the business between the firm and the client is, or is to be, carried on; (2) the client specifically consents to the provision of that information in that form; (3) the client is notified electronically of the address of the website, and the place on the website where the information may be accessed; (4) the information is up to date and (5) the information is accessible continuously by means of that website for such period of time as the client may reasonably need to inspect it.

In case investment services are offered at a distance to consumers, the question arises how this rule relates to the information requirements laid down in the Directive on distance marketing of consumer financial services. More specifically, article 5 of the Directive on distance marketing of consumer financial services requires that the information enumerated in article 3 of the Directive and the contractual terms and conditions are communicated on paper or on another durable medium available and accessible to the consumer. As already indicated a website normally does not constitute a durable medium. Contrary to the Directive implementing MiFID the Directive on distance marketing of consumer financial services does not contain exceptions to this rule. We believe that MiFID and its implementing Directive do not derogate from the rules incorporated in the Directive on distance marketing of consumer financial services, which implies that information which must be communicated in virtue of the Directive on distance marketing of consumer financial services, must always be communicated in writing or in a durable medium.

4.5 Burden of proof

It is clear that it is up to the investment firm to prove that it has fulfilled its obligation to provide the specific information required by MiFID and its implementing Directive. In this context the question arises whether the investment firm can reverse the burden of proof by letting the client declare that “he received all information required”. We find such generally formulated clause contrary to the European legislator’s intentions, since many retail clients will not know which information has to be provided. However if the retail client is not a consumer, there is, at least in Belgium, not much that can be undertaken against such clause. But if the retail client is a consumer one has to take into account article 74, 21° of the Belgian Act on Market Practices and Consumer Protection which prohibits terms that reverse the burden of proof to the detriment of the consumer.

4.6 Sanction

MiFID does not contain civil sanctions that can be imposed on investment firms that do not respect the rules of conduct discussed above. In Belgium it is accepted that general principles of civil law can be applied to sanction the violation of the rules of conduct (Wymeersch, 1995). More specifically, the nonfulfillment of the obligation to provide information constitutes a fault, which will entitle the retail client to a compensation if he suffers damages by it. For example, the retail client will be entitled to a compensation if he consents to a transaction because he did not receive all information required with regard to the risks involved or because the existing risks where not explained to him in an understandable way. In determining the amount of the compensation one has to take into account the damages suffered and the profits lost (De Vuyst, 2004).

In certain cases, i.e. where the same information must also be provided by virtue of other legislation, one can also apply the sanction incorporated in that specific legislation. Reference can be made to article 11 of the Directive on distance marketing of consumer financial services, which determines that Member States must provide for appropriate sanctions in the event of the supplier's failure to comply with national provisions adopted pursuant to this Directive. More specifically Member States provide for this purpose that the consumer may cancel the contract at any time, free of charge and without penalty. The Belgian legislator has actually used this possibility. Article 55of the Belgian Act on Market Practices determines that the consumer, at least in certain cases and as far as certain conditions are met can terminate the agreement free of charge. However this sanction is not very interesting / useful for a consumer who has suffered important damages, for example because he has not been properly informed about the existing risks.

4.7 Evaluation

At first sight an extensive list of information that needs to be provided seems very interesting. However one must be careful not to jump to conclusions, especially in the relation to consumers. More specifically we believe that the information that must be provided to consumers in a durable medium is too extensive, which creates the risk that most consumers will not take notice of the information, including the information which is essential to them (e.g. information concerning the risks involved), especially because the information is often presented in lengthy language. We argue that consumers will be better protected if they receive less information, i.e. information which is limited to elements that are of major concern to them when taking an investment decision. For example: the implementing Directive requires the investment firm to inform the retail client about the policy of the investment firm with regard to conflicts of interest. Most consumers do not even know what a conflict of interest is. It is not the first time the European legislator makes this mistake. The Directive on distance marketing of consumer financial services also obliges financial institutions to provide too much information (Prüm, 2002 and Steennot, 2007). Too much information is not a good thing, since it not only creates costs for investment firms, but also because in reality it leads to a reduction of consumer protection. The transaction costs of taking notice of all the information are simply too high.

We believe it would be better to limit the information that must be provided in a durable medium to that information that is interesting and necessary for an average consumer to make an informed investment decision. Most important here is information with regard to the costs of the transaction and the risks involved. Such information should be presented in short simple sentences. Other information required by the implementing Directive will without doubt be interesting for some consumers or retail investors. Therefore this information must also be accessible, for example on the website of the investment firm to which the durable medium refers. But in order to avoid that the average consumer is overwhelmed by the quantity of the information, only the most essential information must be mentioned in the durable medium (or on the first webpage if the information is given through a website).

5. Obligation to obtain certain information

5.1 In general

Article 19.4 MiFID creates the obligation on behalf of the investment firm to obtain certain information from the client. The rationale behind this rule is that an investment firm will only be able to serve its clients' best interests if it knows which kind of client it is dealing with. Therefore this rule is also called the "know your customer" rule. In what follows, we will make a distinction between three categories of investment services: 1) portfolio management and investment advice, 2) execution – only services and 3) investment services that fall in between the two former categories. The distinction between these three categories is really important since the degree to which the investor is protected will greatly differ. Before actually describing the "know your customer" rule, we will illustrate the difference between execution-only services and other investment services (not constituting investment advice or portfolio management).

5.2 Categories of investment services

In case of an execution – only service the role of the investment firm is limited to the execution of client orders and / or the receipt and transmission of these orders. A good example of an execution-only service relates to the situation where a client enters an investment firm and asks to buy or sell certain company shares and the investment firm only executes or transmits the order. Examples of investment services that cannot be regarded as portfolio management or investment advice, but neither as execution-only services are: the situation where the investor is sent/lead in a certain direction on the basis of a conversation with the investment firm or on the basis of advertisements that suggest in general terms that a specific product is appropriate for a certain category of investors (Moloney, 2007).

5.3 Content of the obligation to obtain certain information

5.3.1 Portfolio management and investment advice: suitability test

When providing investment advice or portfolio management the investment firm must obtain the necessary information regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives. Such information must enable the investment firm to recommend to the client or potential client the investment services and financial instruments that are suitable for him (art. 27.4 MiFID). More specifically the investment firm must assess whether the specific transaction to be recommended, or entered into in the course of providing a portfolio management service is such that the client is financially able to bear any related investment risks consistent with his investment objectives. According to CESR this means that the investment firm must verify that the client has sufficient resources to settle the proposed transaction and it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio (art. 35 Implementing Directive). This rule clearly implies that an investment firm cannot advise investment services and in the course of providing a portfolio management service cannot enter into transactions that do not meet the client’s profile. Therefore it is the investment firm and not the investor who decides in the end whether a certain transaction meets the client’s interests. A recommendation to the client, stating that the transaction does not match his profile, is not sufficient.

Once again the content of this obligation to obtain information is further elaborated in the Implementing Directive which determines what kind of information must be obtained regarding the financial situation, the investment objectives (art. 35 Implementing Directive) and the client’s knowledge and experience in the investment field (art. 37 Implementing Directive). More specifically, the information regarding the financial situation of the client or potential client must include, *where relevant*, information on the source and extent of his regular income, his assets, including liquid assets, investments and real property, and his regular financial commitments. The information regarding the investment objectives of the client or potential client must include, *where relevant*, information on the length of time for which the client wishes to hold the investment, his preferences regarding risk taking, his risk profile, and the purposes of the investment. Finally, the information regarding a client's or potential client's knowledge and experience in the investment field must include the following, *to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved*: (1) the types of service, transaction and financial instrument with which the client is familiar; (2) the nature, volume, and frequency of the client's transactions in financial instruments; and (3) the period over which they have been carried out; the level of education, and profession or relevant former profession of the client or potential client.

The rules on investment services clearly differ from the rules on consumer credit that are incorporated in the Consumer Credit Directive. According to article 9 of the Directive a creditor must, before the conclusion of the credit agreement, assess the consumer's creditworthiness on the basis of sufficient information, where appropriate obtained from the consumer and, where necessary, on the basis of a consultation of the relevant database. However the Consumer Credit Directive, contrary to the Belgian Act on Consumer Credit, does not prohibit the creditor explicitly from providing credit to a client probably not being able to reimburse the credit. A second distinction between the rules on investment services and the rules on consumer credit lies in the fact that the consumer credit directive does not determine precisely which information has to be obtained with regard to the investor’s financial situation.

If an investment firm, when providing the investment service of investment advice or portfolio management, does not obtain the information required under article 19.4 MiFID, the firm cannot recommend investment services or financial instruments to the client or potential client. Therefore it will not be enough to warn the investor that not giving the information asked for can have prejudicial effects on the capability of the investment firm to assess whether the transaction concerned is suitable for him. In this context the question also arises whether the investment firm has to verify the information obtained from its client. The answer to this question is clearly no. There is only one exception to this rule. The investment firm cannot rely on the information obtained if it knew or should have know that the information was manifestly out of date, inaccurate or incomplete (art. 37.3 implementing Directive).

When an investment firm provides an investment service to a *professional* client it is entitled to assume that, in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge. Where that investment service consists in the provision of investment advice to a professional client covered by Section 1 of Annex II to Directive 2004/39/EC, the investment firm may assume that the client is financially able to bear any related investment risks consistent with the investment objectives of that client (art. 35.2 implementing Directive).

5.3.2 Appropriateness-test

In case investment services other than portfolio management or investment advice are provided and which cannot be regarded as execution-only services (or do not meet the conditions set to enjoy the specific regime of execution-only services (infra nr. 26)), a lighter regime applies. Investment firms must ask the client or potential client only to provide information regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded (art. 27.5 MiFID). The goal of this obligation to obtain information with regard to the clients' knowledge and experience in the investment field is to enable the investment firm to assess whether the investment service or product envisaged is appropriate for the client, i.e. whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or investment service offered or demanded (art. 36 Implementing Directive). An investment firm is entitled to assume that a professional client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular investment services or transactions, or types of transaction or product, for which the client is classified as a professional client (art. 36 implementing Directive).

The obligation to find out whether a specific product or service is appropriate is less far reaching than the obligation to examine whether the investment advice or a transaction in portfolio management is suitable. First, in case the suitability test must be performed, more information needs to be obtained, more specifically information with regard to the client's financial situation and his investment objectives. Secondly, in case the suitability test applies, the investment firm has to evaluate every transaction taking into account the client's entire portfolio (Moloney, 2007). This implies that it is possible that the transaction as such is suitable, but such transaction cannot be advised because of the fact that the execution of the transaction would have as an effect that the composition of the portfolio no longer reflects the client's profile.

The aim of the lighter regime of appropriateness is to simplify current sales practices, to reduce costs to the consumers and to encourage them to make active choices about the products and services offered (ECON Committee's Recommendation for the Second Reading on the Council MiFID Common Position A5-0114/2004, Amendment 19).

Contrary to what happens in case of investment advice and portfolio management the investment firm may provide the investment service if the potential client does not give all the information the investment firm has asked for. However in such situation, the investment firm must warn the client or potential client that such a decision will not allow the firm to determine whether the service or product envisaged is appropriate for him (art. 19.5 MiFID). This warning may be provided in a standardized format (art. 19.5 MiFID), but it cannot be included in the questionnaire addressed to the client, since such inclusion could encourage the client not to provide all information asked for (see: art. 37.2 Implementing Directive).

There is another distinction between on the one hand investment advice and portfolio management and on the other hand other investment services that cannot be regarded as execution only services. In case an investment firm believes, on the basis of the information obtained from the client, that the product or service is not appropriate for the client or potential client, it may nevertheless provide the service. The only thing it must do is warn the client or potential client. This warning may also be provided in a standardized format.

5.3.3 Execution-only services

In case investment firms provide investment services that only consist of execution and/or the reception and transmission of client orders, they do not need to obtain information from the client with regard to his financial situation or investment objectives, neither with regard to his knowledge and experience in the investment field (art. 19.6 MiFID). However this rule, which implies that no information at all needs to be obtained, only applies where certain conditions are met: (1) the investment services must relate to shares admitted to trading on a regulated market or in an equivalent third country market, money market instruments, bonds or other forms of securitized debt (excluding those bonds or securitized debt that embed a derivative), UCITS or other non-complex financial instruments (eg derivatives, such as options and futures, must always be considered as complex financial instruments not falling under the lightest regime where no information must be obtained); (2) the service must be provided at the initiative of the client or potential client; (3) the client or potential client must have been clearly informed that in the provision of this service the investment firm is not required to assess the suitability of the instrument or service provided or offered and that therefore he does not benefit from the corresponding protection of the relevant conduct of business rules; this warning may be provided in a standardized format and (4) the investment firm must comply with the rules on conflict of interests.

If one of these requirements is not met (e.g. when the transaction relates to a complex financial instrument) the investment firm will have to evaluate whether the investment service or financial product is appropriate for that client, taking into account his knowledge and experience in the investment field with regard to that specific product or service.

5.3.4 Burden of proof

It is up to the investor to prove that the investment firm did not ask for all relevant information. The Supreme Court in Belgium has decided similarly with regard to the obligation on behalf of the creditor to obtain information from the consumer who wants to conclude a credit agreement (Cour de Cassation 10 December 2004, *Nieuw juridisch Weekblad* 2005, 951; *Revue critique de Jurisprudence Bele* 2005, 680, note J.P. BUYLE, *Journal des juges du paix* 2007, 392, note R. STEENNOT). However, the Court also stated that the creditor must cooperate at the level of proof. If we apply the same reasoning to investment services this means that the judge, although the burden of proof is imposed on the investor, can ask the investment firm to present a written or electronic document indicating the questions asked and the answers given by the consumer.

Contractual clauses letting the *consumer* declare that all required information has been asked for create to our view a significant unbalance between the rights and obligations of the parties. First it will be nearly impossible for an individual consumer to actually prove that not all relevant information was asked for. Secondly, these types of contractual clauses could lead to a total depletion of one of the basic rules of conduct. As already mentioned contractual clauses creating a significant unbalance between rights and obligations are null and void in Belgium.

5.3.5 Sanction

As already indicated MiFID does not contain civil sanctions that can be imposed on investment firms that do not respect the rules of conduct discussed above. In Belgium it is accepted that the general rules of civil liability can be applied (this is however not the case in all member states). This implies that fault, damages and causal link have to be proven. The mere fact that the rules of conduct were violated makes it clear that there has been a fault. Nevertheless the investment firm can only be held liable if the investor can prove that such fault has caused damages.

According to Belgian law a distinction must be made between pre-contractual (i.e. extra-contractual) liability (art. 1382 Civ. C.) and contractual liability. The investment firm will be held liable on the basis of article 1382 of the Civil Code when it did not gain all the information required by law. The liability will be of a contractual nature when the investment firm does not take into account the information obtained when providing investment services, for example when it does not respect the investment objectives (Wymeersch, 1995).

6. Conclusion

It is clear that information requirements can protect the investors' best interests. The obligation to obtain certain information from the investor before offering investment services, as elaborated by the European legislator, adds much value, at least if one accepts that the investment firm has to cooperate at the level of proof, meaning it has to be able to present a document proving that the information required was asked for. Information requirements clearly vary: where the investor opts for higher levels of advice, progressively heavier obligations are imposed on the firm, the lightest regime applying to execution only services meeting several requirements. However, one must not forget that even in case no information must be gained, the investment firm remains obliged to provide information to the retail investor, including a warning that the firm will not verify whether the given service is appropriate for that customer. All these information requirements should guarantee that the client makes an informed decision, i.e. whether or not to ask for advice and which transaction to conclude.

The only problem at this point is that the European rules require the investment firm to provide so much information, that an average *consumer* will be very reluctant to take notice of all the information, including essential information on risks and costs. Therefore we believe it would be better to differentiate between the essential information that must indeed be communicated in a durable medium, in short for consumers easy understandable sentences, and which must be communicated before the conclusion of the agreement or provision of the investment service and other information that should only be accessible, for example on the website of the investment firm.

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