

# INVESTMENT SERVICES AND ACTIVITIES AGREEMENT ON CAPITAL MARKET

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## Abstract

*Investment services and activities on the account of the investors shall be supplied under a contract drafted in accordance with Capital Market Laws.*

*Intermediaries (investment firms) hold the market access monopoly to trading systems of the regulated market or multilateral trading systems. Contracting them is the only way for investors to have access (indirectly) to trading through market orders.*

*The legal framework shaped by the contract regarding investment services and activities is the premise, the mandatory and preliminary condition for the sale or purchase of financial instruments. The contract of investment services and activities is thus a sine qua non for trading on the capital market.*

**Keywords:** capital market, investment services and activities agreement, regulated market, trading system, investment firm.

## 1. Investment services and activities.

Investment services and activities have a legal demarcation. The main services for investors are: reception and transmission of orders in relation to one or more financial instruments, execution of orders on behalf of clients, portfolio management, investment advisory services, underwriting of financial instruments and placing of financial instruments on a firm commitment basis or without a firm commitment basis. Along with these main services the law also sets ancillary services which consist of safekeeping and administration of financial instruments for the account of clients, granting credits to an investor to allow him to carry out a transaction, advice to undertakings on capital structure, foreign exchange services connected to the provision of investment services, services related to underwriting.<sup>1</sup> Main services includes also services and activities that exceed the provision of customer services: dealing on own account, operation of an MTF (multilateral trading facility) or operation of an OTF(organized trading facility). Contemplating these services and activities it is easy to extract the essence of the investment services and activities agreement: performing legal acts and deeds regarding the financial instruments or following the order of the client.

## 2. Legal nature of the investment services and activities agreement.

At the declarative level, although the legislator is not legally consistent, the intermediary (services provider) works on behalf of the client, suggesting the

existence of a legal relationship based on a full power of attorney (mandate with representation).

The effects of the intermediary's activity will be reflected in the client's assets by the purchase or sale of financial instruments. Investment firms (SSIF in Romanian Capital Markets Laws) will undoubtedly work on their client's account. European rules use this formula, the client's account, to compare with the transaction that employs the SSIF's own funds, dealing on own account. Therefore "execution of orders on behalf of clients" means acting to conclude agreements to buy or sell one or more financial instruments on behalf of clients and "dealing on own account" means trading against proprietary capital resulting in the conclusion of transactions in one or more financial instruments<sup>2</sup>.

The execution of stock transactions takes place through stock exchange mechanisms, on behalf of the intermediary. Orders are executed by intermediaries (investment firms) in the multilateral market system in their own name (between two initial SSIFs, then between each SSIF and the CCP (central counterparty clearing house, a specialized legal entity of the regulated market mechanism)) with the effects being made on clients' accounts.

The agreement concluded between investment firms and clients seems to be, from the perspective of the entire mechanism of the conclusion and execution of the market orders, as a mandate without representation.

In fact, the conclusion of transactions by the intermediary exclusively on behalf of the client would compromise the stock market celerity, would mean the multiplication of the legal relations between the specialized market participants (market operator, central securities depository (CSD), central

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<sup>1</sup> Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU, Annex I, Section A and B.

<sup>2</sup> Directive 2014/65/UE (MiFID II), Art. 4 para (1) no 5.

counterparty (CCP)) with the number of investors participating in the stock exchange.

Otherwise, direct legal relationships only concern investment firms which deal in their own name and the rest of the capital market specialized participants.

Investors just take advantage of these pre-existing legal relationships as the investment firms works on their own behalf as part of the legal relationship with the trading market institutions. The intermediary provides services to the client and concludes legal acts in his own name but on the client's account.

The service provider generally carries out proprietary trades. However, the service provider may act in the name of and on account of the client.

### 3. A priori assessment of the adequacy and appropriateness of the services and activities offered to investor.

The investment firm shall collect information from the clients about their knowledge and experience regarding financial investments in order to determine their financial skills, provide appropriate warnings about the risks inherent in transactions on capital market and provide client tailored services.

Pursuant to the regulations, the client shall be classified in the retail or professional clients category<sup>3</sup> and shall be informed of its right to ask for a different categorization, under the conditions defined in the regulations. The client shall also be informed of the consequences which could result concerning its degree of protection<sup>4</sup>.

*Retail clients* are afforded the most regulatory protection while *professional clients* are considered to be more experienced and able to assess their own risk and make their own investment decisions so they are afforded less regulatory protection.

According to Capital Markets Laws, the following shall be regarded as *professionals* in relation to all investment services and activities and financial instruments: entities which are required to be authorised or regulated to operate in the financial markets (as well as credit institutions, investment firms, insurance undertakings, collective investment schemes and management companies of such schemes, pension funds and management companies of such funds and other institutional investors), large undertakings meeting two of the following size requirements, on a proportional basis: balance sheet total at least 20.000.000 Euro, net turnover at least 40.000.000 Euro, own funds at least 2.000.000 Euro, national and regional governments, public bodies that manage

public debt, central banks, international and supranational institutions (such as the World Bank, the International Monetary Fund, the European Central Bank, the European Investment Bank and other similar international organisations) and other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financial transactions<sup>5</sup>.

Any clients not falling within this list are, by default, retail clients. Even if they are on the list above such entity can ask for a higher level of protection where it deems it is unable to properly assess or manage the risks involved.

Clients may be treated as professionals on request following some identification criteria as well as: frequent significant transactions, portfolio size or financial expertise<sup>6</sup>. Such clients may waive the benefit of retail client status only where the following procedure is followed: they must state in writing to the SSIF that they wish to be treated as professional clients (either generally or in respect of a particular investment service), SSIF must give them a written warning of the protections and investor compensation rights they may lose and they must state in writing, in a separate document from the contract, that they are aware of the consequences of this professional status.

*Eligible counterparties* are entities (to which a credit institution or an investment firm provides the services of reception and transmission of orders on behalf of clients or execution of such orders) as well as: investment firms, credit institutions, insurance companies, UCITS and UCITS management companies, pension funds and their management companies, other financial institutions authorised or regulated under Union law or under the national law of a Member State, national governments and their corresponding offices including public bodies that deal with public debt at national level, central banks and supranational organisations<sup>7</sup>.

The retail client has the right to request the different classification of professional client but he will be afforded a lower level of protection. SSIF is not obliged to accept this request. Also the professional client has the right to request the different classification of retail client in order to obtain a higher level of protection. The eligible counterparty has the right to request a different classification of either as a professional client or retail client in order to obtain a higher level of protection.

If the client stops providing the information requested by the regulations to the investment firm, the latter would no longer be in a position to assess the appropriateness of the financial instrument and shall

<sup>3</sup> Annex II, Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU.

<sup>4</sup> Art. 25, Directive 2014/65/EU.

<sup>5</sup> Directive 2014/65/EU, Annex II.

<sup>6</sup> *Ibidem*. The client has carried out transactions, of significant size, on the relevant market at an average frequency of 10 per quarter over the previous four quarters, the size of the client's financial instrument portfolio exceeds 500.000 Euro, the client works or has worked in the financial sector for at least one year in a professional position.

<sup>7</sup> *Ibidem*, Article 30 para (2).

draw the client's attention to the risks it could incur due to the inappropriateness of the financial instrument compared to its profile.

Regarding order execution, the investment firm shall not be required to collect the information needed for client's assessment if the service is provided at the client's initiative (and if the investment firm warns the client prior to the execution of orders that no assessment the appropriateness of the service or the financial instrument is provided).

### 3. Execution policy.

Best execution principle implies the investment firm's obligation to take all reasonable measures, during order execution, to obtain the best possible outcome for its clients, under the conditions defined by regulations<sup>8</sup>.

Where an investment firm (SSIF) executes an order on behalf of a retail client, the best possible result shall be determined in terms of the total consideration, representing the price of the financial instrument and the costs relating to execution (which shall include all expenses incurred by the client which are directly relating to the execution of the order).

For the purposes of delivering best possible result where there is more than one place to execute an order for a financial instrument, in order to assess and compare the results for the client that would be achieved by executing the order on each of the execution place, the SSIF's own commissions and the costs for executing the order on each of the eligible execution places shall be taken into account in that assessment<sup>9</sup>.

However, if the client asks investment firm for a quotation for a financial instrument transaction, such firm shall not apply its execution policy. Investment firm, acting as counterparty for its client, shall not be substituted for its client in deciding the best way to carry out such a transaction.

If the investment firm agrees to accept an order including a specific instruction given by the client, it shall execute the order in accordance with that instruction. The client is clearly informed that the investment firm was prevented from carrying out the measures stipulated in the execution policy in respect of the conditions imposed in the clients' instruction.

If the client places a limit order relating to shares accepted for trading on a regulated market and this order is not immediately executed under the conditions prevailing on the market, the investment firm shall take measures to facilitate the order execution as quickly as possible, by making it immediately public in a form easily accessible to other market participants<sup>10</sup>.

When the investment firm provides the service of reception-transmission of orders, the entities to which

client orders are transmitted for execution are selected on the basis of ensuring the best possible execution. Unless otherwise specified by the client, he shall consent to the executing of his orders outside a regulated market or a multilateral trading facility by signing the investment services agreement.

The execution policy of the investment firm shall be disclosed entirely and separately to the client.

By submitting an order to the SSIF (investment firm) the client explicitly acknowledges to the investment firm's execution policy.

### 4. Order confirmation.

For the order execution service, the client shall receive a confirmation on a durable medium (fax, letter or email) at the latest on the first working day following the order execution (if the firm receives confirmation of the execution from a third party, at the latest on the first working day following the reception of the confirmation from this third party).

The confirmation shall contain all the information such as the name of SSIF (the investment service provider) issuing the confirmation, the client's name, the date, type and nature of the order, the name, the volume and price by unit of the financial instrument, the venue of execution.

The client is informed that, given the time taken to send the confirmation, it should generally arrive within 24 hours. The client is therefore asked to notify the firm if said confirmation has not been received within 48 hours of the order having been passed.

Periodic reports shall include details about price, costs, speed and manner of execution for individual financial instruments<sup>11</sup>.

Investment firms shall be able to demonstrate to their clients that they have executed their orders in accordance with the investment firm's execution policy according to the law.

### 5. Conflicts of interest.

SSIF (investment firm) has a written policy aimed at preventing, identifying and, also, managing in an equitable manner any conflict of interest that may arise during the provision of investment services and activities. The conflicts may arise between the interests of the SSIF and its clients, or between the interests of two or more of its clients.

The expanding range of activities that many SSIFs undertake simultaneously has increased potential for conflicts of interest between those different activities and the interests of their clients.

SSIFs shall take effective steps to identify and manage conflicts of interest and mitigate the potential

<sup>8</sup> Art. 27, Directive 2014/65/EU.

<sup>9</sup> Art. 27 para (1), Directive 2014/65/EU.

<sup>10</sup> Art. 28 para (2), Directive 2014/65/EU.

<sup>11</sup> Art. 27 para (3), Directive 2014/65/EU.

impact of those risks as far as possible. Where some risk of detriment to the client's interests remains, clear disclosure to the client of the general nature and sources of conflicts of interest to the client and the steps taken to mitigate those risks should be made before undertaking business on his behalf<sup>12</sup>.

## 6. Clients' obligations

The investor who is party to the investment services and activities agreement undertakes to pay the SSIF the remuneration due to it in respect of the activities and services provided. Furthermore, the client shall compensate SSIF for any expense or damage likely to be (directly or indirectly) borne by the latter.

The investor shall provide SSIF full evidence regarding his identification, the identification of his shareholders, representatives, managers, agents and ultimate beneficiaries of the transactions in compliance with the regulations regarding anti money laundering and the financing of terrorism.

## 7. Distance agreement.

A distance contract means any agreement for the purpose of services and investment activities concluded between an investment firm (S.S.I.F.) as a provider and an investor as a beneficiary of services and investment activities, in the context of a system of sales or service and distance investment activities organized by the SSIF which, for the purposes of that contract, uses only one or more means of distance communication<sup>13</sup>.

Such distance communication represents any means which, without requiring physical presence of the parties (SSIF and the beneficiary of services and

investment activities) may be used for the purpose of achieving the agreement of the parties.

The investor has a 14 day term from the day of conclusion of the distance contract to terminate the contract without having to justify the termination decision and without incurring punitive fees.

In the case of unilateral denunciation, the investor may be required to pay the services rendered up to that date, according with the terms of the agreement.

The right of withdrawal from a distance contract shall not apply to investment services and activities the price of which depends on the fluctuations in the financial markets that may occur during the withdrawal period of the contract<sup>14</sup>.

## Conclusions.

The investment services and activities agreement shall govern relations between the investor and the SSIF (investment firm) in relation to the supply by the service provider of investment services as defined in MiFID II (Directive 2014/65/EU, Annex I) and national law (Law no 126/2018, Annex 1).

The service provider shall reveal his business on the exchange and commodity markets, as well as financial instruments, securities, money market instruments, unit trusts and types of derivatives instruments that it deals with.

SSIF shall indicate regulated markets, multilateral trading facilities (MTF) or organized trading facilities (OTF) where the transactions are carried out on.

SSIF carries out proprietary trades or it may act in the name of and on behalf of the client.

The investment services and activities agreement shall apply to all transactions concluded by the SSIF carried out at the client's order.

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<sup>12</sup> Preamble, no 56, Directive 2014/65/EU.

<sup>13</sup> Art. 60 para (3), (4), Law no 126/2018.

<sup>14</sup> Art. 60 para (8), Law no 126/2018 Fluctuations may be generated by: money market instruments, securities participation in collective investment undertakings, futures contracts, including similar contracts with final settlement in funds, forward rate agreements (FRA), interest rate swaps, exchange rates and shares or options.