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Implementation of Directive 2004/39/EC on Markets in
financial instruments (Repealing Directive 93/22/EEC on
Investment services in the securities field) in Lithuania

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**IMPLEMENTATION OF DIRECTIVE 2004/39/EC ON MARKETS IN
FINANCIAL INSTRUMENTS (REPEALING DIRECTIVE 93/22/EEC ON
INVESTMENT SERVICES IN THE SECURITIES FIELD) IN LITHUANIA**

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INTRODUCTION:

Growing world's financial markets globalization turned European Union into the most competitive financial market in the world. Directive 2004/39/EC on Markets in Financial Instruments (also well know as MiFID) effective since 1 November 2007 is the keystone of this objective. The goal of MiFID is to integrate all 27 markets of EU Member States into single European financial market. MiFID will serve as competent regulator of united European market, meanwhile MiFID is taking into account peculiarities of national legislation of Member States. MiFID replaced the Investment Service Directive, which was the most significant piece of European Union legislation for financial markets and investment intermediaries since 1995. However, it worth to mention, that MiFID has the same objectives as the Investment Services Directive, meanwhile different ways and means of achieving this objective. MiFID promotes harmonization of European law along with three basic principles: increased financial market effectiveness, enlarged competition between Member States, and ensuring better investor protection. The new Directive extends the coverage of the Investment Services Directive regime and introduces novel and more strict requirements for investment intermediaries.

Aim of this dissertation: is to explore the implementation of Markets in Financial Instruments Directive in Lithuania and identify its impact on Lithuanian market.

Tasks of this dissertation:

This work consists of introduction, seven main sections and conclusion.

In section 1 I will consider why being a Member State of EU is carrying a great value for Lithuania. I also will discuss how entrance to the EU has influenced the political and economical situation in the country. The section 2 focuses on the legal nature and objectives of EU

directives. Via section 3 I strived to discuss significant role of investment services and activities in development of Lithuania's economy.

In section 4 contains a review of Investment Services Directive, namely a long journey made by Investment Services Directive to the MiFID. Also I will argue why the Investment Service Directive had to be replaced by the MiFID and the main changes brought by this new Directive. Intermediaries, providing investment services in Lithuania will be examined in section 5. Section 6 directly focuses on the main changes that were introduced by MiFID in European = Lithuanian regulation of financial markets. Areas that was directly touched and updated by MiFID were explicitly analyzed and discussed in this section. In order to achieve goals of section 6 I have explored secondary and supplementary sources of EU law, Laws and other legal acts of the Republic of Lithuania containing transposed and implemented MiFID provisions, also issued by the Securities Commission different Regulations. Section 7 is dedicated to the Consultation on the Review of the Markets in Financial Instruments Directive (MiFID II). In this section I will explore how preliminary proposals of this Consultation would affect weak areas of MiFID, which includes best execution and the transparency of trading. Conclusions constitute a culminating part of my dissertation.

1. THE WAY OF LITHUANIA TO THE EUROPEAN UNION

Lithuania became a full member of the European Union relatively recently, only seven years ago. But for this short period of time had occurred positive changes in the economy of the country, the quality of life became better, was marked growth of wages, likewise, that is important, 71 % of the population are satisfied with the entry of Lithuania into the EU¹.

Thus Lithuania had joined the European Union in 2004, however, it is difficult to determine the exact date when Lithuania has started the way to Europe.

Somehow, it was historically proven, that Lithuania faced with the Europe considerably earlier than Lithuania state had been established. The King of Lithuania Mindaugas (had governed the Kingdom of Lithuania from 1236 till 1263) christening and coronation, later on Gediminas, the Grand Duke of Lithuania (had governed the Kingdom of Lithuania from 1316 till 1341) letters to the Pope and to the Heads of Western European states proved that Lithuania actively attempted to find a proper place in Europe even seven centuries ago. Christianized medieval Lithuania eventually established itself alongside the modern Christian Europe states.

After the ending of the First World War in the early twentieth century, ruined Europe was reluctant to rethink the value of the coexistence among European nations on the basis of

¹ Spinter research Ltd. <<http://www.spinter.lt/site/lt/vidinis/menuTOP/9/home/publish/MTc4Ozk7OzA>> accessed 5 July 2011

democratic principles. Conception of native equality had built the conditions for Lithuania to recapture sovereignty and independence, however, restored Lithuania merely for short while returned to the way of European integration. The totalitarian regime instantly spread in East and West Europe, collapsed conceptions of consolidated Europe, likewise led to the Second World War and the half-century-long split of the Europe. On the one side of the Europe essential principles of democracy were observed and process of European integration continued. Another part was occupied by Soviet Union.

Lithuanian independence was restored in 11 March 1990. Thereupon, in 27 August 1991 followed the official recognition of independence of the Republic of Lithuania by the European Community. Mentioned above developments gave chance to Lithuania to establish and develop official relationships and cooperation between Lithuania and the European Community.

The way of Lithuania to the European Union was enduring and thorny (in particular, for brand new state it was difficult to meet the Copenhagen Criteria²), but in spite of all faced obstacles, Lithuania became an EU member state on 1 May 2004.

1.1. Economic, political and other antecedents that led Lithuania to the European Union

Valdas Adamkus, the President of the Republic of Lithuania, in President's Annual Report on 20 April 2000 outlined the vital significance of the European Union for the Lithuania. He claimed that: 'Certainly, we may try to eliminate without any support a decades long gap between the West countries and Lithuania. But we should not forget that the Western world is not static and progresses more quickly than we do. Therefore Lithuania can avoid the fate of a backward province only by catching the high-speed train of Europe and being a fully paid-up passenger on that train. We should understand that membership in the European Union will not bring us a better life. But it will provide more favourable conditions for building our well-being'.

Thus, why to be a part of united Europe carry the highest value for Lithuania? To answer this question, it is essential to consider benefits that imply membership in EU, in particular for Lithuania.

Political benefits:

- 1) Oversight over fundamental human right observance:

² Where Copenhagen Criteria are rules that govern which country can join the European Union. For country-prospective member state, to become member of the EU, that country must meet the Copenhagen criteria that were defined by the European Council in Copenhagen, Denmark in June 1993.

Signed in Rome in 1958 Treaty establishing the European Economic Community proclaimed principle of human right observation and respect. This means that any of the EU Member States should not restrict human rights of their citizens, otherwise the EU has the right to intervene, and thereby the EU serves as a guarantee of internal stability and fundamental freedoms.

2) National Security:

The EU ensures security for its Member States. Whereas EU constitutes a huge trading alliance, which involves 27 Member State countries with their domestic markets, thus in case of military attack country-aggressor takes risks to lose trade relations with such enormous international market.

3) Expansion of political influence:

As a competent Member State of the EU, Lithuania has its representatives at all EU structural units, also in law-making body, that creates EU legislation. That provides the opportunity for Lithuania directly participate in the legislative process, particularly to influence decisions with regards to regional issues. Also, it is worth to mention, that membership in worldwide recognized European Union, Lithuania acquires greater influence in bilateral relations between different countries.

4) Maintenance of peace:

The EU was created in the first place to achieve political, rather than economical objectives. As the first European communities - predecessors of the EU were created during post war period, with objectives to maintain peace across the Europe and in relation with this was established that Member States all disputes arising from economical and political matters should resolve amicably, excluding declaration of the war by one EU member state to others.

Economic benefits:

1) Development of international trade and attraction of foreign investors

Lithuania's integration to the EU allowed increase exports of Lithuanian goods to the EU member countries. Thus by year 2006, only two years passed after Lithuania joined the EU export of Lithuanian goods to the EU countries rose from 61.4 % in 2003 to the 63,2 by the year 2006.³ Likewise, Lithuania will become attractive for foreign investors to place their funds in Lithuanian companies, that allows to create additional work places, and thereby significantly to reduce unemployment rate in the country.

2) The EU support to the poorest regions:

³ Lietuvos Statistikos Departamentas, 'Užsienio prekyba 2006 metais', <<http://www.stat.gov.lt/lt/pages/view/?id=2071>>, accessed 20 June 2011

One of the EU objectives is to eliminate difference between richest and poorest between the richest and poorest European regions. In capacity of the EU member state Lithuania is able to use the funds of the EU to support infrastructure development, environmental protection and social affairs.

3) Higher quality of life:

The EU provides the high level of consumer protection, environment protection and large-scale business regulatory standards. The EU also guarantees more security for all European citizens through joint efforts in the fight against crime, drugs and illegal immigration.

2. THE EUROPEAN UNION DIRECTIVES AS INSTRUMENTS TO HARMONIZE AND REGULATE EUROPEAN MARKET

2.1. Legal nature of the EU Directives

Article 249 of Treaty of European Union (hereinafter in the text Treaty) states, that European Parliament acting in conjunction with the Council of the Europe, and the European Commission shall issue directives.

By the reason, that the EU don't provide unified legal definition of the directive, I would like to describe 'directive' as a directly applicable legal act adopted by the European parliament that set objectives and principles of the EU, which is addressed to the Member States, and is binding to comply with. The EU recognizes the right of Member States to implement directives only to certain extent, and leaving the choice to apply their own forms and methods to achieve addressed to them directives goals (Article 249 (3) of the Treaty), however it is worth to mention, that this freedom is restricted by certain requirements, for instance, relevant national measures should correctly reflect the content and objectives of the directive; institutions, responsible for directive transposition or implementation into national law should comply with time framework detached to fulfil directive's objectives; also Member States should choose proper forms and methods of incorporation.

Answer to the question why on the one hand the EU rigorously demand Member States to follow the principles and to achieve objectives of the Union, but from on the other hand provides the freedom to choose form is methods is based on the EU aspiration to respect as far as possible the sovereignty and law-making power of the Member States, in particular the position of national parliaments. Similarly, freedom to choose forms and methods enables the Member States to take into account national (legal or other) features, and economic, social, and other

circumstances when implementing a directive⁴. Thereby directive constitutes an instrument of limited intervention into national law of Member States.

2.2. Functions of Directives

With respect to regulated area the effect of the EU directives on national legal system can distinct and come thought harmonization and regulation.

Primarily, the EU uses directives in areas where existing national law is rather complex and need to be adopted to achieve objectives of the European Union, in particular to harmonize the national laws⁵.

However, directives have other destination, and recently became used as an instrument for liberalization, aiming to provide consumers with better quality of products and services at an affordable price. Objectives of such kinds of directives are regulation of domestic markets in accordance with the EU internal policy. Nowadays that regulation covers different areas of economics, administrative regulation and other areas.

2.3. Stages of Directives' implementation

The term 'implementation' refers to the carrying out of public policy.⁶ With regards to the directives term implementation means fulfilment of obligations, imposed by certain directive, which are binding to observe⁷. Structurally process of implementation can be divided in few separate stages: *transposition*, *application* and *enforcement*.

Transposition is the first stage of directive's implementation, which constitutes process of incorporation of directives into national legislation, namely the legal acts of different hierarchy of legislation. Transposition also involves the process of authority's delegation to the certain bodies for application of transposed provisions. Selection of applicable specified national measures to transpose the directive into national law appear in capacity of second stage of this process. Finally, the last stage, *enforcement* constitutes the process of observance over the directive.

2.4. The system of the EU law implementation in Lithuania

⁴ Sacha Prechal, 'Directives in EC Law' (2nd rev edn. Oxford University Press 2006) 73

⁵ Sacha Prechal, 'Directives in EC Law' (2nd rev edn. Oxford University Press 2006) 3

⁶ www.answers.com, Definition – term 'Implementation', <<http://www.answers.com/topic/implementation>>, accessed 20 June 2011

⁷ Article 249 (3) of the Treaty of European Union obliged all Member States to achieve objectives of addressed to them directives.

In accordance with the figures of European Commission's reports Lithuania takes the leading position among new Member States of the EU in amount of implemented in national law the EU directives. Thus by 8th March 2007 has implemented 2 821 directives, in other words 99, 1 % of total amount of addressed to Lithuania directives 2 832⁸.

General legal acts that regulates provisions that contains in the EU legal acts transposition and implementation into Lithuanian national law are: Constitutional Act of Republic of Lithuania on membership of the Republic of Lithuania in the European Union⁹ (the Constitutional Act), Resolution Nr. 21 of the Government of the Republic of Lithuania on coordination of the EU affairs in Lithuania of 9th January 2004¹⁰ (the Resolution) and Regulation of coordination of European Union affairs in Lithuania (Regulations)¹¹, adopted by the Resolution.

Article 2 of the Constitutional Act proclaimed that the European Union law is considering as an integral part of Lithuanian legal system. Likewise, was declared primacy of the EU provisions of law over Lithuanian national legislation in conflicts of laws.

Article 38 of the Regulations states that government authorities and agencies under their jurisdiction are directly responsible for transposition and implementation of the European Union legislation into national law. In turn, established under the Ministry of Justice of Republic of Lithuania the European Law Department (the European Law Department) is directly responsible for harmonization of the EU law implementation in Lithuanian legislation.

Accession to the EU obliged Lithuania to create a system according to which the EU law will be transposed and implemented into provisions of national Lithuanian law by the competent national legislative bodies.

⁸ 'Lithuania and Latvia takes a leading position in implementing the EU directives', (Information Bureau REGNUM, 21 March 2007) <<http://www.regnum.ru/news/polit/799902.html>> accessed 21 June 2011

⁹ Lietuvos Respublikos Konstitucinis Aktas dėl Lietuvos Respublikos narystės Europos Sąjungoje //Valstybės Žinios, 1992, Nr. 33-1014

¹⁰ Lietuvos Respublikos Vyriausiasis 2004 metų sausio 9 dienos Nutarimas Nr. 21 'Dėl Europos Sąjungos reikalų koordinavimo'// Valstybės Žinios, 2004, N. 8-184

¹¹ Europos Sąjungos reikalų koordinavimo taisyklės

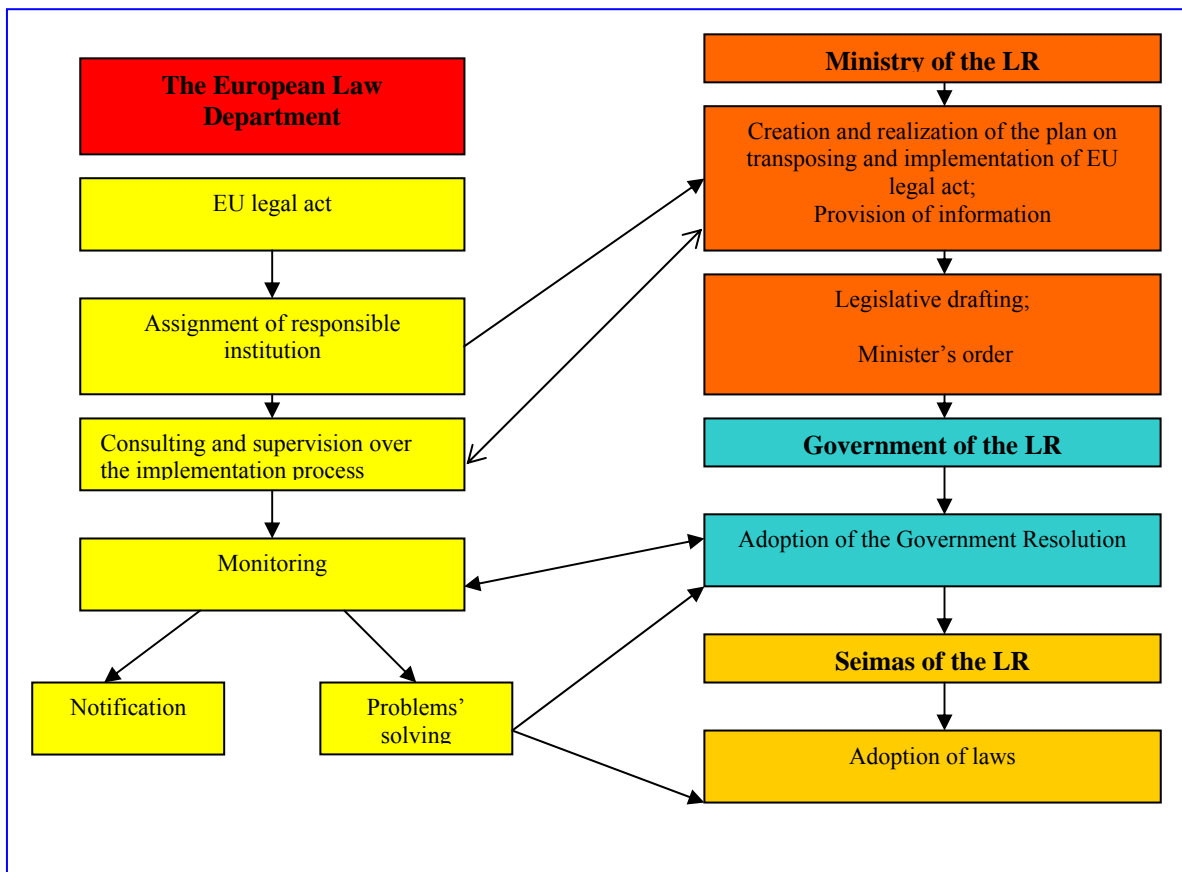


Figure 1: The system of transposition and/or implementation of EU law into national Lithuanian legislation

This system can be defined as a system with detailed description of procedures, transparent allocation of responsibilities between local authorities, likewise flexible problem-solving mechanism.

The complete process of transposition and implementation is laid down in the Regulation. The first step in the process is distribution of the European Law Department of binding to fulfil directives to governmental institutions the scope of competence which is close or directly connected with the matter that affects the certain directive. Afterwards, within three weeks after distribution of authorities' responsible institutions should provide the European Law Department with the detailed preliminary plans that are exposed to changes during the process of transposition or implementation.

In compliance with article 41 (41.1) of the Regulations the plan should contain information on the legal act wherein the provisions of directive will be transposed or implemented, its legal title, similarly to provide an exact date of this act's adoption, date of placing of this act to the Government of Republic of Lithuania for consideration and rendering the resolution. On a monthly basis responsible governmental institutions and agencies provide the European Law department with current information on the binding to transpose or implement directives plan. In turn, the European Law Department evaluates conveyed data, and further send

summary of data to the European Commission. Alike the European Law Department is responsible to Committee on European Affairs (the Committee) under the Seimas¹² of Republic of Lithuania and is obliged monthly to inform the Committee about governmental bodies and institutions prepare drafts of the laws, to implement there provision of the directive.

After the formal adoption and subsequently published in the governmental newspaper 'State News' legal act or acts wherein were transposed or implemented provisions of a directive, the European Law Department initiate the process of notification, which represent an official informing of European Commission on transposing or implementation of directive into national law, as well as to provide the Commission with the adopted legal act's legal language and other relevant information.

3. THE LEGAL NATURE OF INVESTMENT

According to article 2 (1) of Law on Investments term 'investments' means funds and tangible, intangible and financial assets assessed in the manner prescribed by laws and other legal acts, invested in order to obtain from the object of investment profit (income), social result (in education, culture, science, health and social security as well as other similar spheres) or to ensure the implementation of state functions¹³.

However, in legal literature¹⁴ distinguishes three basic approaches to meaning of term investments. The first approach is economic definition of investment, to which can be attributed definition of term 'investments' that was given in the Law of Investments. This economic approach distinguishes two types of investments: investments in real assets (for instance, real estate, land or engendering tools), and investments in financial instruments (for example, shares and bonds). Investments into real assets are made within the company. Companies often use their profit as a source of investments, in order to develop the business, for expansion of production, and also to introduce the new technologies, hoping that made input in future will create a greater wealth. Investment into financial instruments are made by outside investors, and represent a provision of own funds to support direct investments projects of the company. Typically, investors aiming to carry out placement of funds in set of securities, which forms a 'portfolio', therefore this kind of investments is termed 'portfolio investment'. In other words, 'portfolio investment' designates placement of funds into set of securities (for instance, shares, bonds, derivatives). The goal of 'portfolio investment' is to gain an expected yield meanwhile facing the lowest acceptable risks rate.

¹² Legislative body of the Republic of Lithuania

¹³ Lietuvos Respublikos Investicijų Įstatymas // Valstybės Žinios. 1999, Nr. 66-2127

¹⁴ Iain G MacNeil, 'An Introduction to the Law on Financial Investment' (Oxford: Hart Publishing 2005) 3

Legal definition of term investment constitutes a second approach. This approach focuses on investment as property and the legal rules associated with ownership of that property. Along the process of investing represents a third approach. It is focuses on institutions, that are associated with investment (for instance, the Securities Commission of the Republic of Lithuania that is the securities market supervisory authority) laws, rules and other set of legal acts that regulates the process and procedures of investment.

3.1. The impact of the investment on economic performance

The investment process plays an important role in international economic relations. Amount of attracted placement of funds inside the country indicates country's dynamic growth, steadily developing economy, as well as competent governmental policy in the sphere of attraction of investments. Factors that directly influence amount of an investment refers to increase in production, financial solidity, competent policy solutions and strategic excellence in integrity in relation to taxation, reduction of bureaucracy and other urgent matters. With regards to the state policy in the sphere of attraction of investments every singular country while development of this policy bear on the individual for each certain country indices, such as political, industrial, economic, financial and others.

3.2. Investment in Lithuania

During recent decades was noticed a gradual growth in economics' of Lithuania, that led to significant increase of standard of living, namely become able to save money. The growth of savings along with favourable credit policy encouraged to invest excess money into different types of securities, shares, bonds and other investment objects (concerning local investment).

Furthermore, it worth to mention that for developing Lithuanian economy great value has an attracted foreign investors, which lately more willingly have chosen Lithuanian market to place their funds, because the dynamic economic growth, a strong legal framework to protect investors, harmonized with the EU law, liberal tax code, and an educated and highly motivated workforce constitutes a solid platform for successful placement of funds in Lithuania. For instance, according to preliminary data, the first quarter of 2011 of the foreign direct investment in Lithuania reached 800.4 million LTL¹⁵ (Litas)¹⁶. This data according to Academician Anton

¹⁵ Statistics Lithuania, 'Foreign Direct Investment in Lithuania in first quarter of 2011' <<http://www.stat.gov.lt/lt/news/view/?id=9197>> accessed 3 August 2011

Buracas may be considered as very good result for Lithuania, bearing in mind that during the full swing of the global financial crisis investment inflow has reached only several dozen million Litas, while some quarters were generally negative¹⁷.

3.3. The role of financial institutions in investment process

While some investors make their own investment decisions and invest directly many others seek financial and investment advice from financial intermediaries, who are financial institutions. Article 2 (7) of Republic of Lithuania Law on Financial Institutions¹⁸ describes the financial institution like an undertaking of the Republic of Lithuania or an establishment of a foreign state's undertaking operating in the Republic of Lithuania in accordance with the procedure set forth by the laws regulating the provision of financial services and activities of financial institutions and engaged in the provision of one or more financial services. In turn the article 3 (8) of that Law states that investment services refer to financial services.

Thus, what financial services represent investment services? Answer to this question was given in article 3 (13) of Law on Market in Financial Instruments, where following services and activities are considered as investment: 1) reception and transmission of orders; 2) execution of orders on behalf of clients; 3) dealing on own account; 4) management of a financial instrument portfolio; 5) provision of investment advice; 6) underwriting and/or placing of financial instruments on a firm commitment basis; 7) placing of financial instruments without a firm commitment basis; 8) operation of a multilateral trading facility.

4. INVESTMENT SERVICES DIRECTIVE: THE FIRST ATTEMPT TO CONSOLIDATE EUROPEAN FINANCIAL MARKET

Until the end of the year 2007 core the European Union legal act defining the fundamental principles of the Single European securities market functioning, was the Council Directive 93/22/EEC of 10 May 1993 on investment services in the securities field (hereinafter in the text Investment Services Directive). Investment Services Directive entered into force on 1 January 1996, and had created a commotion in regulatory regimes of three major financial services: investment services, banking and also insurance.

¹⁶ The Lithuanian litas is the currency of Lithuania (ISO currency code LTL). According to the Bank of Lithuania currency exchange rates on 3 Augusts 2011 1 GBP worth 3,9565 LTL.

¹⁷ www.alfa.lt 'Auga tiesioginės užsienio investicijos Lietuvoje' (ELTA, 22 June 2011) <
http://www.alfa.lt/straipsnis/11960193/Auga.tiesiogines.uzsienio.investicijos.Lietuvoje=2011-07-22_08-12/>
accessed 3 August 2011

¹⁸ Lietuvos Respublikos Finansų Įstaigų Įstatymas// Valstybės žinios, 2002, Nr. 91-3891

The regulatory framework ascertained by Investment Services Directive was comprehensive; under scope of its application felt all types of investment firms. The Directive has introduced a novel European passport regime, the conception of the regulated market, which represents a competent participant of financial services market, licensing of intermediaries-investment services providers, emphasizing the importance of proper investors protection, in order to ensure transparent and fair functioning of Single European market.

The Investment Services Directive embodies concepts that are broadly used in the securities market, and in fact, it combines twelve regulatory approaches resting on differences in national legislation of Member States into a coherent system of regulation of the financial services market.

4.1. Acts amending the Directive on Investment Services in the Securities Field

Striving to enhance the EU legislation aimed at improving the market's infrastructure, in other words to improve the regulation of financial institutions' activities, in order to promote transparent and safe trading, European Parliament in conjunction with the Council of the EU adopted few directives amending regulations of the core Directive 93/22/EEC.

Thus in 29 June 1995 was adopted Directive 95/26/EC amending Directive 93/22/EEC in the field of investment firms specifically that concerns communications between authorities for the entire financial sector. Adopted on 3 March 1997 Directive 97/9/EC directly related with investors' rights protection, and require all Member States to set up investor compensation schemes. Directive 2000/64/EC adopted on 7 November 2000 amends the Directive as regards exchange of information with third countries. Directive 2002/87/EC adopted on 16 December 2002 introduces specific prudential legislation for financial conglomerates as back-up for the sectoral prudential legislation applicable to credit institutions, insurance companies and investment firms. It provides for minimum alignment of the prudential legislation for homogeneous groups active in a single sector (banking, insurance, investment) on that applicable to financial conglomerates, both with a view to protecting consumers, depositors and investors and with a view to strengthening the European financial market¹⁹.

¹⁹ <http://europa.eu/>, 'Summaries of EU Legislation', <http://europa.eu/legislation_summaries/internal_market/single_market_services/financial_services_banking/l24036c_en.htm>, accessed 4 August 2011

With special attention should be treated Directive 2004/39/EC of 21 April 2004 on Markets in Financial Instruments²⁰, also well known as MiFID with effect from 1 November 2007, which officially repealed Directive 93/22/EEC, but together included a number of its provisions.

The adoption of MiFID marked the completion of certain stage of financial services development within the European market, which begun its formation with adoption of fundamental Directive on investment services in the securities field. Directive 2004/39/EC (as in the Investment Service Directive with regard to that period of time, indeed) reflects present-day trends concerning efficient and secure management of the financial services market.

Furthermore, as states the MiFID recital, arose necessity to provide a higher level of financial services regulation, in order to carry out successful trading in securities field, regardless of the used methods. Meanwhile, it is also essential to take into account a brand new generation of multilateral trading facilities along with the existing regulated markets, which should also be subject to regulation in order to ensure the efficient and ordered functioning of financial markets.

The provisions of MiFID directly addressed to all 27 Member States of the EU and three European Economic Area states, where before the MiFID adoption had operated different for all Member States rules and requirements. The goal of MiFID is to unite all these rules and requirements to one set which allows to simplify the trade of financial instruments around the Europe. Also there is need to mention, that like an integrated part of the EU Financial Services Action Plan²¹ MiFID is pursuing following objectives: 1) integration of national financial markets into single financial European market; 2) creation of a comprehensive ‘European’ regulatory regime for providers of investment services; to exterminate the monopoly of stock exchanges; to provide proper level of investors’ protection, which depends on assigned category of investors’; harmonization of market rules and tightening up of supervision over market participants. MiFID directly affects following investment services and activities providers: investment firms, stock exchanges and multilateral trading facilities (MTFs). Equity markets,

²⁰ The MiFID covers virtually all financial instruments. According to article 4 of Law on Market in Financial Instrument ‘financial instrument’ mean any of the following instruments: 1) transferable securities; 2) money market instruments; 3) securities of collective investment undertakings; 4) options, futures, swaps, forward rate agreements and any other derivative contracts relating to securities, currencies, interest rates or yields, or other derivatives instruments, financial indices or financial measures which may be settled physically or in cash; 5) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to commodities that must be settled in cash; 6) Options, futures, swaps, and any other derivative contract relating to commodities that can be physically settled provided that they are traded on a regulated market and/or an MTF; 7) Options, futures, swaps, forwards and any other derivative contracts relating to commodities, that can be physically settled and not being for commercial purposes; 8) Derivative instruments for the transfer of credit risk; 9) Financial contracts for differences; 10) Options, futures, swaps, forward rate agreements and any other derivative contracts relating to climatic variables, freight rates, emission allowances or inflation rates or other official economic statistics that must be settled in cash or may be settled in cash at the option of one of the parties.

²¹ Where Financial Services Action Plan (FSAP) is a Plan of the EU, which objective is to create a single market in financial services

commodity and derivatives markets, and to some extent bond markets falls under the scope of MiFID application.

The MiFID regime consists of two levels. The MiFID Level 1 (framework Directive 2004/39/EC), consist of 73 Articles and was adopted in 2004. The MiFID Level 2 (implementing Directive 2006/73/EC) was adopted in 2006, consists of 55 Articles, and covers the nature of investment advice, prudential organizational requirements, conflict of interest management, and conduct of business regulation, best execution, order handling, and eligible counterparty concept.

4.2. Implementation of Directive 2004/39/EC on Markets in Financial Instruments in Lithuania

According with the European Commission formal request the EU Member States, including Lithuania was obliged to transpose into national law the Markets in Financial Instruments Directive and implement it, by the deadline of 31 January 2007. In view of the extensionality of MiFID it became difficult for Member States to implement its provisions on schedule. Thus, by adoption on 5 April 2006 Directive 2006/31/EC amending Directive 2004/39/EC, as regards certain deadline, the European Commission provided Member States with extra time until 1 November 2007 to implement into national law the full application of the rules.

To transpose and implement MiFID Seimas of the Republic of Lithuania have adopted Republic of Lithuania Law on Markets in Financial Instruments (MiFIL), which has entered into force on 18 January 2007.

The purpose of the MiFIL is to govern public relations in order to ensure a fair, transparent and efficient functioning of markets in financial instruments, protection of investor's interests and to provide prudential management of systemic risk. The established requirements of the MiFIL are addressed to financial brokerage firms and regulated markets operating in Lithuania.

5. LITHUANIAN FINANCIAL MARKET STRUCTURE

5.1. The Security Commission

Significant role in regulation of markets in financial instrument assigned to the Security Commission of the Republic of Lithuanian (hereinafter – the Security Commission), which as states the Article 69 of MiFIL represents the Supervisory Authority of Markets in Financial

Instruments. The main objectives of the Security Commission are listed in Article 71 (1), and they are following: 1) to monitor the compliance with the rules of fair trading in financial instruments; 2) to take measures assuring effective functioning of the market in financial instruments and protect the interests of investors; 3) submit proposals with regard to shaping of the State economic policy which would promote the development of the market in financial instruments; 4) disseminate information about the principles of functioning of markets in financial instruments.

The Securities Commission's adopted Regulations implement and complete provisions of the MiFID and MiFII, and represents manual for participants of Lithuanian financial market and also are widely used by prospective investors.

5.2. Stock Exchange

Stock exchange is a specialised public limited company engaged in the provision of services aimed at concentration by organisational and technical facilities of the supply and demand of securities, thus enabling trading parties to conclude transactions in accordance with the trading rules. An entity may operate as a stock exchange only with prior authorisation from the Securities Commission. Although a stock exchange is functioning not only as intermediary, but as an important securities regulator. The stock exchange adopts its internal trading and tenancy rules, which are subject to the approval of the Security Commission. The stock exchange may request disclosure by its members on their financial and commercial activities, and it has the power to verify members' compliance with the exchange regulations and apply sanctions where violations are found to have occurred.

Vilnius Stock Exchange was established in 1993 however on 30 May 2005 the National Stock Exchange became a member of NASDAQ OMX Group. Inc. together with stock exchanges in Riga, Tallinn, Helsinki, Stockholm, and Copenhagen. Vilnius Stock Exchange is directly connected with the stock exchanges of Riga and Tallinn. The Vilnius, Riga, and Tallinn stock exchanges have formed a joint Baltic market to facilitate access and minimise investment barriers when operating in the Estonian, Latvian, and Lithuanian markets. The basic features of the market are: a common Baltic list of securities; a common index of Lithuanian, Latvian, and Estonian securities; a common trading system and access point for Lithuania, Latvia, and Estonia; common market information websites for all three states (for instance, NASDAQ OMX website: <http://www.nasdaqomxbaltic.com/market/?lang=en>); and harmonised market regulations practices and practises.

5.3. Regulated Market

Under MiFID the regulated market means a multilateral system operated and/or managed by a market operator, which brings together or facilitates the bringing together of multiple third-party buying and selling interests in financial instruments - in the system and in accordance with its non-discretionary rules - in a way that results in a contract, in respect of the financial instruments admitted to trading under its rules and/or systems. Lithuanian stock exchange NASDAQ OMX Vilnius is listed in the Committee of European Securities Regulators MiFID database as an exclusive operator of regulated markets²². At present day there are four regulated markets operating in Lithuania. These are: Baltic Main List, Baltic Second List, Baltic Funds List and Baltic Bond List. The Securities Commission on frequent basis supervises and monitors compliance of NASDAQ OMX Vilnius with legal acts and rules for assigned for stock exchange.

5.4. Multilateral Trading Facility (MTF)

MiFID has introduced a many novelties in Lithuanian investment services industry, namely in year 2007 Vilnius Stock Exchange has launched the first in Lithuania multilateral trading facility i.e. OMX Alternative Market First North.

Multilateral trading facilities (hereinafter in the text MTF) represent a new investment service under the MiFID, with significant direct impact on regulated markets. MTF was created with design to eliminate regulated market monopoly, and provoke fair competition for order flow. Article 3 (2) of the MiFID provides legal definition of MTF. Thereby, MTF means a multilateral system operated by a financial brokerage firm or a market operator which, in accordance with non-discretionary rules, brings together third-party buying and selling interests in financial instruments in a way that results in a contract on financial instruments. At present time, in Lithuania operates merely one MTF – First North Lithuania²³. First North Lithuania is an alternative market, operated by the different exchanges within NASDAQ OMX. Thereafter, companies traded via this alternative market are subject to the rules of First North instead of legal requirements applicable for regulated markets.

The First North gives to trading companies' greater visibility and ease of access to equity capital, combining the benefits of being on-market with simplicity. Trading companies' are subject of lighter regulation requirements. Constant oversight and monitoring over those

²² Committee of European Securities Regulators 'MiFID Database: Regulated Markets' <http://mifiddatabase.cesr.eu/Index.aspx?sectionlinks_id=23&language=0&pageName=REGULATED_MARKETS_Display&subsection_id=0&action=Go&ds=23&ms=8&ys=2011&mic_code=MIC%20Code&full_name=Full%20Name&cpage=1> accessed 18 August 2011

²³ Committee of European Securities Regulators 'MiFID Database: Multilateral Trading Facilities' <http://mifiddatabase.cesr.eu/Index.aspx?sectionlinks_id=22&language=0&pageName=MTF_Display&subsection_id=0&action=Go&ds=21&ms=8&ys=2011&mic_code=MIC%20Code&full_name=Name&cpage=3> accessed 18 August 2011

companies provide local stock exchange, and First North certified advisors²⁴. A main advantage of First North comparably with regulated market i.e. NASDAQ OMX Vilnius, is that companies' admitted to trading are not exposed to strict trade information disclosure requirements, that applied to companies' trading in regulated market, including preparation of financial statements in accordance with International Financial Reporting Standards. However, this flexibility has a downside; companies trading via alternative market are more likely to face a higher level of investment risks and liquidity problems than in regulated markets. Thought this may mean a higher return on investment. First North is suitable for all industries and businesses of all sizes, however more intended for small and medium-sized, less liquid, but fast-growing joint stock companies.

Indeed, in spite of all granted benefits, alternative market has its drawbacks as well.

'Law Firm Sorainen' lawyer Algirdas Peksys, claims, that company's admission to alternative market is directly linked with publicity. On the one hand, if a company has something to be proud, publicity, in this case will have only positive impact on company's performance and shares pricing. On the other hand, the company is obliged to disclose information which may not always be favourable to it and will affect negatively both: the company's reputation and shares pricing. It also worth to mention, that trading on alternative market is referred to additional expenses: information disclosure along with operation in it costs: employees should spend extra time in order to comply with alternative markets rules, similarly companies are charged for certificated advisors services²⁵.

Nevertheless, trading via alternative market is a great opportunity for companies whose performance doesn't enable to trade shares on regulated market, to raise additional capital, to set its value in the market, as regards shareholders and investors, they will benefit too, as shareholders will get a chance to sell their shares, and investors, in return to create a modern multiple portfolio.

5.5. Systematic Internalisers

Article 4 (7) of MiFID defines a systematic internaliser as an investment firm which, on an organised, frequent and systematic basis, deals on own account by executing client orders outside a regulated market or an MTF. Systematic internalisers act as an experienced counterparty to customers orders. The list of systematic internalises can be found in the CESR

²⁴ List of certificated First North advisors can be found there: NASDAQ OMX First North, 'List of Certificated Advisors' <<http://firstnorth.nasdaqomxbaltic.com/en/advisers/list-of-certified-advisers/>>

²⁵ Violeta Bagdanavičiūtė, 'Į Vertybinių Popierių Rinką – Kitų Keliu' (eVERSUS, 19 July 2007) <<http://finansai.eversus.lt/naujienos/174>> accessed 19 August 2011

MiFID database, in which two Denmark banks: Danske Bank and Nordea Bank Danmark, operating in Lithuania are assigned as systematic internalisers²⁶.

Systematic internalisers quote prices and quantities at which they are prepared to buy or sell shares for their own account and trade accordingly by executing bilaterally against the customer. Systematic internalisers generally trade in relatively small sizes with either retail or professional customers or both. Systematic internalisers are subjects of less expansive disclosure requirements, because the trading transacted with systemic internalisers is considered as less transparent than trading conducted on regulated markets and MTF. Furthermore, systematic internalisers quotes are not widely disseminated or readily accessible; systemic internalisers may decide which investors they wish to give access to their quotes. For the vast majority of investors, the current calibration of the systemic internalisers regime offers little utility or choice - such is the narrow focus of the transparency framework. More meaningful quoting obligations, and more widely disseminated quotations, are necessary to better meet investors' needs²⁷.

5.6. Investment services providers

In Lithuania, the provision of investment services and investment activities is a licensed activity. Therefore, merely listed below entities may provide an investment services and activities.

Financial Brokerage Firms (hereinafter in the text FBR). FBR under Article 3 (7) of MiFID is defined as a legal person whose regular occupation or business is the provision of one or more investment services to third persons and /or the performance of one or more investment activities on a professional basis. The Security Commission issues three types of licenses (Class A, B and C) to FBR in accordance with the Rules on the Issuance of the Licence to a Financial Brokerage Firm, approved by the Resolution No 1K-32 of 30 October 2007 by the Security Commission.

Financial Brokerage Departments of Commercial Banks holding a license from the Central Bank of the Republic of Lithuania. The general banking licence does not restrict their right to engage in the provision of investment services.

²⁶ The Committee of European Securities Regulators 'MiFID Database: Systematic Internalisers' <http://mifiddatabase.cesr.eu/Index.aspx?sectionlinks_id=16&language=0&pageName=MIFIDSystematicSearch&subsection_id=0> accessed 19 August 2011

²⁷ CFA Institute, 'The Structure, Regulation, and Transparency of European Equity Markets under MiFID' (2011) <<http://www.cfasociety.org/spain/es/Documents/Estudio%20MiFID%20CFA%20Instiutte%20January%202011.pdf>> accessed 19 August 2011

Licensed Branches of Foreign FBR and Cross-border FBR providing investment services in Lithuania without establishing a branch under the MiFID easy access passporting regime.

6. MAIN CHANGES INTRODUCED BY MiFID

Majority provisions of MiFID merely re-express existing regulations. However, some of the provisions are brand new for investment services regulation, and to this end lead to significant changes in the operation of EU financial services markets. In this section of my work I will examine the main changes brought by MiFID, their implementation into the Law on Markets in Financial Instruments, and discuss how these changes affect the Lithuanian market on financial instruments.

6.1. Clients' Classification

In order to ensure the highest protection of investors, in proportion to their knowledge and experience in financial markets, provisions of Article 31 of MiFID require that firms, covered by Directive before providing investment services or performing investment activities assigned the investor to one of the following categories of clients: retail, professional or eligible counterparties.

6.1.1. Retail clients

Clients, having small experience or lack of experience in investment services, ranked to the most vulnerable category of investors' and therefore should be treated with the highest level of investors protection. This category of investors is defined as retail, and to it usually reckons natural persons also small and medium entities.

Because retail's investor knowledge of financial instruments, market and financial products that are circulating is limited, thus retail investor should be provided with generalized, easily accessible and structured information about certain financial instruments and investment services, investment strategies and associated risks whether the financial brokerage firm offer those services to client, or client apply for them personally.

To ensure implementation of basic objectives of MiFID and MiFII, namely to protect properly investors' rights and interests the Security Commission on 26 November 2009 has

issued Interpretation Nr. 13K-10²⁸. According to this interpretation heads of financial brokerage firms should ensure that investment services to retail clients will be provided only by staff with appropriate qualifications and universally recognized documents to verify the professionalism, experience and adequate knowledge of financial markets (for instance, a brokerage license). On that basis the Commission encourages heads of financial brokerage firms to improve customer service staff training, by that to ensure the highest level of retail clients' protection, but also to preserve themselves from human error probability.

In the same way Interpretation Nr. 13K-10 set out rules applicable to making of investment advises to retail clients. Thus competent and licensed financial brokerage firm's employees should develop a questionnaire and an automatic system that will evaluates the information submitted from this questionnaire completed by retail client. On the basis of received and decently analyzed information brokers should select an appropriate standardized investment proposal, i.e. notably suitable for certain client investment strategy for a specific financial instrument or instruments. In this context, standardized investment proposal is considered as investment advice, which is subject of rigorous requirements imposed by effective legal acts.

As regards a questionnaire, it should be composed of standard questions, invoking client to provide information about his knowledge and experience in the investment field, financial status, client's specific goals, investment risk tolerance level, and other relevant client's profile describing information.

However, in some exceptional cases, retail clients may request that investment company change an investment category from retail to professional (for example, to invest only for professional clients available financial instruments, or become a client of company, which does not provide services to retail investors) on conditions that clients should be convinced with their ability to make the investment decisions, will be able to assess and identify investment risk factors which may be encountered.

6.1.2. Professional clients

MiFIL distinguishes two approaches related to category of professional clients. The first approach, professional clients, without separate acknowledgement (Article 27 (1)), shall be deemed to include: financial brokerage firms, other licensed and regulated financial institutions, insurance companies, collective investment undertakings and the management companies

²⁸ Lietuvos Respublikos Vertybinių Popierių Komisijos 2009 m. lapkričio 26 d. Išsiaiškinimas, Dėl asmenų, per kuriuos finansų maklerio įmonės ir kredito įstaigos teikia klientams investicinės paslaugas, kompetencijos ribų?, Nr. 13K-10.

thereof, pension fund and the management companies thereof, commodity and commodity derivative dealers, own-account future dealers and other institutional investors. The professional clients specified in this item include the entities licensed and regulated in the Member States of the European Union or third countries; 2) large undertakings; 3) 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 EIB and other similar international organisations; 4) other institutional investors whose main activity is to invest in financial instruments, including entities dedicated to the securitisation of assets or other financing transactions.

Under the second approach (Article 28 (3)), clients in their request can be recognized and treated as professional clients if they comply with at least two of the following criteria: 1) over the previous four quarters the client in the relevant market has carried out, on average, 10 transactions of significant size; 2) the size of the client's financial instrument portfolio, defined as including monetary funds exceeds EUR 500 000; 3) the client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged. On the basis of a greater experience and sufficient knowledge in investment field professional clients could be subject to a lower level of protection.

6.1.3. Eligible Counterparties

The third category of investors represents institutional investors that are counterparties. The eligible counterparties shall include financial brokerage firms, investment firms, credit institutions, insurance companies, UCITS and their management companies, pension funds and their management companies, other financial institutions authorised or regulated under Community legislation or the national law of a Member State (Article 29 (2)). Due to the fact that this category of clients usually is the most experienced in investment, MiFID don't require (with rare exception) to apply to counterparties any investors' protection measures.

6.2. Principle of the best execution

The principle of the best execution based on two approaches. Under the first approach, best execution relates to the requirement of the Article 19 (1) of MiFID (respectively Article 22 (1) of MiFID) to all Member States to ensure, that local investment firms when providing investment services or ancillary services to clients will act honestly, fairly and professionally in accordance with the best interests of its clients. To operate strictly in accordance with best

interests of clients, investment firm should disclose trustworthy information concerning following matters: the investment firm and its services; financial instruments and proposed investment strategies; this should include appropriate guidance on and warnings of the risks associated with investments in those instruments or in respect of particular investment strategies; execution venues, and costs and associated charges (Article 19 (3) of MiFID; Article 22 (4) of MiFII).

The second approach has found its continuation in Article 21 (1) of MiFID (respectively Article 24 of MiFII), which says, that Member States shall require that investment firms take all reasonable steps to obtain, when executing orders, the best possible result for their clients taking into account following factors: price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, whenever there is a specific instruction from the client the investment firm shall execute the order following the specific instruction. Furthermore, the financial brokerage firm is obliged to determine the relative importance of these factors considering the following criteria's: client's category; the executed order's nature; and also the financial instrument's properties; and also execution venue.

Under the scope of obligation of best execution falls all clients' order with instruments (even unique) which under MiFII are defined as financial instruments. Owing to a variety of individual characteristics of certain financial instruments, the financial brokerage firms when carry out clients' orders should take into consideration the type of financial instrument and related to circumstances.

To illustrate written above I would like to consider the Decision Nr. 2K-131 issued on 30 June 2011 by the Securities Commission. According to it R. B. (hereinafter in the text Client) has applied on 27 June 2008 to bank's Snoras financial brokerage department and has submitted assignment (in written form) to buy Gild Arbitrage Risk Capital Fund's (hereinafter in the text Fund) units for 19,900 Euros. Bank has executed the client's order Nr. P89542 by buying 670.6411 Fund's units directly from the management company AS Gild Fund Management. However, made investigation showed that Bank, before execution of client's order didn't offer the client to provide bank with information about his experience and knowledge in the field in of investment services, and didn't assess whether the Fund's units are appropriate financial instrument s for the client: namely, Bank didn't provide client with information about financial instrument nature and it's inherent to this financial instrument to risk profile, which describes the essence of collective investment entities and associated with investment in that Fund risks. It should be noted that the Securities Commission has no evidence (the data provided by the Bank or Clients acknowledgement) that Client has received and was acquainted with issued by Bank

Description on financial instruments and the nature of the risks inherent, because the Bank didn't provide the Securities Commission with a copy of Investment services contract signed by two parties. Furthermore, the Investment services contract (with all attachments, including also Description on financial instruments and the nature of the risks inherent) withdrawn from the banking information system ABS Forpost was blank and wasn't signed by the Client. Moreover, Client states that he merely keeps signed Agreement on a virtue of which Client was classified as retail. On the request, the Bank on 1 April 2011 has provided the Securities Commission with copy of signed on 12 May 2008 Contract on provision investment services to retail client (withdrawn from the banking information system ABS Forpost). The detailed analysis of this Contract showed that Client wasn't properly acquainted with Description on financial instruments and the nature of the risks inherent.

The investigation also found that there aren't any data (documents or Client's acknowledgment) that the Bank, before execution of orders on the account of the Client had introduced Fund rules, although according to approved by the Bank and together with Investors services assigned Description on financial instruments and the nature of the risks inherent clause 12, indicated that in each case it is necessary to explicitly to acquaint Client with investment fund's rules.

The Bank in explanatory note states, that financial brokerage firm isn't obliged to apply to orders on the account of the Client provisions of the Article 22 (3) of MiFID, namely, to provide clear and understandable information to existing or prospective clients, on the ground of which they will be able to find out the nature of proposed investment services and financial instruments, to manage risks, likewise make an informed investment decisions.

Bearing on logical and the linguistic interpretation of Article 22 (3) of MiFID provisions, the Bank incorrectly drawn a conclusion, that because a Client applied only with request to carry out technical transfer to acquire units of the Fund, he wasn't classified as a exciting or prospective client, and therefore the Bank released itself from obligations, imposed by the article 22 (3) of MiFID.

However, according to the Securities Commission explanation, financial brokerage firm should apply provisions of Article 22 (3) of MiFID regardless of the basis of investment services: in conformity with Articles 22 (7) or 22 (10) of the MiFID. It was noted that Article 22 (3) of MiFID shouldn't be interpreted literally, but taking into consideration the objectives of the regulations set up in the article along Article 22 (1), which establishes responsibility of financial brokerage firm when dealing with clients - to act honestly, fairly and professionally in accordance with the best interests of its clients. In accordance with the foregoing, the Securities Commission recognized a Client's claim as reasonable, and has found that the Bank has

breached Article's 22 (3) provisions. Based on the mentioned above, the Bank became a subject of specific sanctions imposition under the Article 87 (1 (4)) of MiFID. However, the Securities Commission found that alleged breach was made in 27 June 2008 and also that established under the Article 87 (2) 2 years term of the imitation to impose sanctions has expired, therefore due to these facts, the Securities Commission decided not to impose upon bank Snoras any sanctions.²⁹

Thus, the principle of best execution is a constituent part of investors' protection method, encouraging the growth of financial markets and ensuring to clients' the best possible result.

6.3. Passporting of financial services

Passporting of financial services is an EU mechanism allowing companies that are authorised to provide financial services in one jurisdiction to provide them in another without the need for authorisation in this second jurisdiction. It can do this by establishing a branch or providing cross-border services.

MiFID introduced a lot of changes in passporting regime, and they are following: widening the scope of passporting to include commodity derivatives, credit derivatives, and financial contracts for differentials; to upgrade advice that involves a personal recommendation to a core investment service that can be passported on a stand-alone basis; clarification that operating an MTF is covered by the passport; introduction a discretionary tied agent regime.³⁰

The core Investment Services Directive introduced a single passport regime, according to which firms with authorisation in one EU Member State have the right to provide products and services, and to establish branches, in all other EU Member States, which, of course, is intended to ensure the cohesion of the EU financial market. These provisions were transposed to the MiFID, however with some significant alterations. Thus, Article 31 (1) of MiFID set out that Member States shall ensure that any investment firm authorised and supervised by the competent authorities of another Member State may freely perform investment services and activities as well as ancillary services within their territories, provided that such services and activities are covered by its authorisation (ancillary services may only be provided together with an investment service and/or activity). Further to mention above Article 31 (1) also provides that Member States may not impose additional requirements on such investment firms. The content of Article 32 (1) regulating establishing of branches is similar to the provisions of Article 31 (1) and states, that investment firms should not be a subject of imposition of additional requirements

²⁹ Lietuvos Respublikos Vertybinių Popierių Komisija, Sprendimas „Dėl Teisės Pažeidimo Bylos AB Bankui „Snoras“ pagal 2011 Gegužės 31 d. Pažeidimo Protokolą Nr. 2K-7 (30 birželio 2011 d., Nr. 2K-13)

³⁰ The Financial Services Authority, 'The Overall Impact of MiFID' (November 2006), 65-66

by Member States' competent authority, with the exception of requirements set out in section 7 of the Article 32.

Significant alterations also touched on the home state control. By Article 16 was strengthened supervision by competent local authority over functioning of foreign investment firms on territory of certain Member State.

6.3.1. Passporting in Lithuania

The Securities Commission represents a coherent link between financial brokerage firm licensed in Lithuania and competent foreign supervisory authority of Member States. Thus under the Article 37 (1) and (2) of MiFID financial brokerage firm wishing to start providing the investment services in another Member State for the first time or which wishes to change the information about Member State, in which a firm intends to operate and submit the programme of operations stating in particular the investment services as well as ancillary services which it intends to perform. Upon the receipt of the information the Securities Commission shall provide such information to the supervisory authority of the host Member State. The financial brokerage firm shall be authorised to start providing the investment services and the ancillary services in another Member State without establishing a branch within one month from the submission of all necessary documents and the information to the Securities Commission.

Thereon foreign financial brokerage firms wishing to provide investment and the ancillary services in territory of Lithuania in both ways: with a establishing a branch (Article 40 of MiFID) or without (Article 38 of MiFID) the Security Commission serves as 'intention' coordinator.

This way, competent supervisory authority of Member State, which financial brokerage firm (however, the firm should hold a licence covering all investment and the ancillary services, firm intending to provide) wishes to provide investment services in Lithuania without establishing a branch should provide the Security Commission with notification letter. The Securities Commission shall make this information public not later than within three working days, by that confirming the admittance of firm to the Lithuanian investment market³¹.

The process of establishment passport for branches in territory of Lithuania is similar with process financial brokerage firms' authorisation without establishing a branch. Identically competent supervisory authority of Member State, which financial brokerage firm wishes establishing a branch should provide the Security Commission with notification letter. Upon the receipt of this notification the Securities Commission shall take all the preparatory arrangements

³¹ Lietuvos Respublikos Finansinių Priemonių Rinkų Įstatymas//Valstybės žinios, 2007, Nr. 17-627 str. 38

for the supervision of the financial brokerage firm and the operational requirements established in public interest³² that the financial brokerage firm shall have to comply with and shall notify the financial brokerage firm accordingly not later than within 2 months. The branch may be established after the financial brokerage firm receives such notification of the Securities Commission.³³

According to the Securities Commission data, with Commission notification in Lithuania has establishing their branches and commencing operations two financial brokerage firms: Evli Securities AS and Terra Markets AS branch, and more than hundred financial brokerage firms without establishing a branch.

To summarize all mentioned above I can deduce that MiFID not only has facilitated access of investment firms to European financial services markets, but apparently increased the supply of investment services in Lithuanian market, due to that should benefit Lithuanian consumers; also it should be noted, that easy access to Lithuanian market provokes a greater competition among investment services providers. Moreover, Lithuanian financial brokerage firms can offer their services to European consumers by a simplified procedure.

6.4. Transparency requirements

Transparency is an essential condition, which is inherent for open investment environment that provides confidence and safeguarding for all financial markets players. In this way, interested parties can monitor and supervise financial markets activities. MiFID significantly changed financial services market framework. Changes touched financial instruments trade arena: before MiFID adoption trade of financial instruments was concentrated in regulated markets. One of the MiFID objectives is to provoke competition among different trading venues: regulated markets, MTFs, engaged in systematic trading financial brokerage firms and credit institutions, dealing outside the regulated market or MTF. Split of financial instruments' trading places, increases potential hazard to transparency of financial instruments' market, to fair and efficient pricing and to proper investors' interests' protection. In order to avoid such negative implications MiFID (respectively MiFII) introduces new disclosure requirements. Transparency requirements, set out in MiFID are called to ensure adequate to disclose amount of information, to preserve financial markets' discipline, to reduce state's interference, similarly, ensures observance of core principal – proper investor's protection.

³² The list of legal rules, that the financial brokerage firm shall have to comply with set out in the Securities Commission Interpretation No 13K-7 issued on 17 September 2009. These regulations are concerned with ascertained in Lithuania regimes relating to: financial services, taxation, prevention of money laundering and others.

³³ Ibidem str. 40

MiFID provides more extensive requirement for transparency, and distinguish twofold disclosure: pre-trade and post-trade transparency.

6.4.1. Pre-trade transparency

The pre-trade transparency it is obligation of certain financial markets participants to disclosure relevant information about bid and offer prices. Under MiFID regulated markets (Article 44 (1) and investment firms and market operators operating on MTFs (Article 29 (1)) are obliged to disclose a current bid and offer prices and the depth of trading interests at these prices in respect of shares. Regulated markets and MTFs should make bid and offer prices available on a continuous basis throughout the trading day on reasonable commercial terms. Compliance with these requirements ensures clear view of the order books, thus making and that in turn ensure a highest degree of transparency.

Contents of the MiFID articles related to the pre-trade transparency set out in MiFID Articles 33 and 35, which were implemented in accordance with rules of the Commission Regulation (EC) Nr. 1287/2006 of 10 August 2006 implementing Directive 2004/39/EC that elaborates the transparency requirements.

6.4.1.1. Waivers from pre-trade transparency

In some exceptional cases, with permit granted by the Securities Commission, taking into consideration market model, type and size of orders, MiFID allows regulated markets and MTF to waive pre-trade transparency requirements (Article 35 of MiFID). Detailed list of exceptional cases is set up in Commission Regulations Nr. 1287/2006, and these include: 1) large-in-scale waiver; 2) negotiated transactions; 3) reference price systems; 4) orders held in an order management facility. Each waiver type will be explained and summarised below.

Large-in-scale orders waiver

According to the Committee of European Securities Regulators, the large-in-scale waiver embodies important alteration provided by MiFID, and was designed to protect large orders from adverse market impact, as the mandatory public exposure for large orders makes the costs of execution higher than if the transaction is not displayed publicly³⁴. The AMF, French Securities Regulator, in Responses to the European Commission Consultation of the MiFID (Review 1) agree with sustainability of the purpose of the large-in-scale waiver, however, think that is no

³⁴ Committee of European Securities Regulators 'Technical Advice to the European Commission in the Context of the MiFID Review - Equity Markets', Ref.: CESR/10-394, [2010]

rationale for considering that orders of equal size, with the same potential market impact should benefit from a waiver depending on whether or not they are the residual portion, and possibly, the very last residual portion of a partly executed large order.

Thus, orders, ranked under the MiFID as large-in-scale, and therefore are excluded from pre-trade transparency must exceed established in Annex II of the Commission Regulations Nr. 1287/2006 minimum size thresholds which depends on the liquidity of the stock in question. The threshold is estimated according to average daily turnover. In contrast, if daily average turnover of admitted to trading on regulated market shares is less than EUR 500,000, each order exceeding EUR 50,000 or equal to this amount is qualifying as large-in-scale. For the most liquid stocks, where average daily turnover exceeds EUR 50 million, a large order starts at EUR 500,000.

Negotiated transactions

Under the rules of Article 19 of the Commission Regulation (EC) Nr. 1287/2006 negotiated transactions mean transactions between counterparties of a regulated market or an MTF, negotiated privately, but executed within the regulated markets or MTFs. Such transactions are exempted from pre-trade transparency.

Reference price waiver

If regulated markets and MTFs carry out equity transactions applying trading methodology by which the price is determined in accordance with a reference price generated by another system, they may waive pre-trade transparency requirements, on condition that the reference price must be widely published and regarded by market participants as a reliable reference price.

Order management facility waiver

The order management facility pre-trade transparency waiver applies to orders held in an order management facility operated by regulated markets or MTFs pending disclosure to the market'. This type of waiver is most commonly used by regulated markets for iceberg orders. Iceberg orders are a type of reserve order that display only a fraction, or the 'tip', of the whole order in the order book. The remainder of the order is held in the order management facility pending disclosure to the market. As the tip of the order is filled, the portion held in reserve is issued to refresh the displayed order to its original size as determined by the parameters of the order management facility. The non-displayed reserve portion is, therefore, gradually depleted as it successively refreshes the displayed order.³⁵

6.4.1.2. Disclosure requirements for systematic internalisers

³⁵. CFA Institute, *'The Structure, Regulation, and Transparency of European Equity Markets under MiFID'* (2011)
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The pre-trade transparency obligations related to systematic internalisers are set out in Article 27 of MiFID (Article 33 of MiFII). The pre-trade transparency requirements applicable to systematic internalisers are less expansive than the requirements for other participants of financial services industry, namely regulated markets and MTF. For systematic internalisers, pre-trade transparency is restricted to sizes of business and specific classes of shares. Because the requirements are restrained, the MiFID doesn't recon waiver framework for exemptions from pre-trade transparency.

Systematic internalisers should publish firm bid and offer quotes for those shares in which they conduct systematic internalisation and where a liquid market exists. These requirements apply to dealings for sizes up to standard market size³⁶. The minimum quoting size is not established. Although, systematic internalisers are exempt from pre-trade transparency requirements if they deal in sizes above standard market size. Systematic internalisers should disclosure their quotes on a continuous basis throughout the trading day and on reasonable commercial terms. The quotes made by systematic should comply with requirement to be easily accessible to other market participants.

6.5. Post-trade transparency

MiFID has introduced changes that directly bear on post-trade disclosure requirements. Under MiFID post-trade transparency requirements apply equally to regulated markets (Article 45 of MiFID; Article 36 of MiFII), MTFs (Article 30 of MiFID; Article 36 of MiFII), and investment firms (Article 28 of MiFID; Article 34 of MiFII). Information about the volume, price and time of execution of all transactions with shares, regardless of where they take place, should be disclose as close to real time as possible and on reasonable commercial terms. The Securities Commission in issued on 8 August 2008 'Pre-Trade and Post-Trade Information Publication Guidelines' Nr. 13K-4³⁷ (hereinafter in the text Guidelines) defined three approaches to 'time of transaction execution'. Hereby, transaction is considered as executed and relevant information about this transaction should be disclosed immediately after: 1) Registered in the order book investors' orders to buy or sell shares were confirmed; 2) Counterparties agreed on the price and volume, in such cases, when transaction is executed outside the regulated markets or MTFs, or when the transaction is executed under the common rules of regulated

³⁶ Which market is considered like 'standard size' defines the ANNEX 2 (table 3) of the of the Commission Regulation (EC) Nr. 1287/2006. The standard market size represents correlation of orders executed with shares to average value of all carried out transactions.

³⁷ Lietuvos Respublikos Vertybinių Popierių Komisijos 'Ikiprekybinės ir Poprekybinės Informacijos Skelbimo Gairės', Nr. 13K-4 [2008] p. 2

markets or MTFs, but not in the Automated Trading System; and 3) Complex transactions, that consists of a several parts are considered as completed when counterparties agreed on all transactions parts.

Article 29 (2) of the Commission Regulation (EC) Nr. 1287/2006 established, that in any event such information should be published within three minutes after relevant transaction was executed. The Guidelines provides further specification of ‘three minutes rule’. Thus, post trade information should be disclosed immediately, but no later than three minutes after relevant transaction execution. However, the maximum acceptable ‘three minutes’ delay threshold may be attained merely in exceptional cases. Insufficient technological capacity (if there is a better, available at a reasonable price technological solutions) doesn’t relates to exceptional cases.

With regards to transactions’ that considering as large relative to the normal market size for the shares in question, MiFID has stipulated waiver framework, and those transactions are exempt from immediate disclosure. Besides, to seize this waiver, counterparties should obtain preliminary the Securities Commission authorisation. Thereby, postponed disclosure of large scale transactions provides parties’ with extra time to decrease the market-impact risk associated with large trades. The Annex II (Table 4) of the Commission Regulation (EC) Nr. 1287/2006 specify differed publication framework for large scales transactions. The publication delays for large scale transactions starts from 60 minutes for stocks with daily average turnover less than EUR 100,000 and the transaction concerned is at least EUR 10,000.

MiFID changes also affected the trade data publishing channels. Investment firms will no longer be required to report on the main stock exchange. They will have the option to publish trade data via the following channels: regulated markets that has admitted the share to trading; MTFs that trades shares; third parties, such as existing or new market data consolidators; or proprietary arrangements³⁸.

7. THE FULL REVIEW OF THE MiFID

In spite of the fact, that MiFID entered into force less then four years ago the European Commission aiming to establishing a safer, sounder, more transparent and more responsible financial system working for the economy and society as a whole in the aftermath of the financial crisis³⁹ guided by the CESR Technical Advices on 8 December 2010 has launched a public consultation on the ‘Review of the Markets in Financial Instruments Directive (MiFID)’ (hereinafter in the text Consultation).

³⁸ The Financial Services Authority, ‘The Overall Impact of the MiFID’ [2006] p 72

³⁹ European Commission ‘Review on the Markets in Financial Instruments Directive (MiFID)’ (2010) 5

Also rapid development of technological achievements, complex and changing structure of financial markets, and crucial lessons learned from the recent financial crisis emphasized the necessity for an extensive review, designated to eliminate revealed drawbacks in certain MiFID regulatory frameworks. The Consultation contains more than one hundred individual proposals. Some of proposals, according to experts would bring significant alterations in existing MiFID regime. Thus the key areas of MiFID that was touched by this review are briefly discussed below.

7.1. Developments in market structure

The Consultation proposes to enlarge a market structure by introducing definition and authorisation requirements for new category of competitive trading venue: organized trading facility (hereinafter in the text OTF), to which refer a broker crossing systems and inter-dealer broker systems that bring together third-party interests and orders. It is assumed that under definition of OTF will fall any facility or system (whether bilateral or multilateral and whether discretionary or non-discretionary) operated by an investment firm or a market operator that on an organised basis brings together buying and selling interests or orders relating to financial instruments. However, the scope of OTF definition excludes facilities or systems that are already regulated as a regulated markets MTFs or systematic internalisers.⁴⁰ This proposal is intended to regulate activities of ‘dark pools’ operators.

7.2. Pre-trade and post -trade transparency obligation

CESR multiply carried out assessment work on imposed by MiFID pre-trade and post-trade transparency requirements (in equity and non-equity markets), which has reviewed a number of issues, including the lack of clarity regarding pre-trade transparency waivers applicable to the equities market, the difficulties in establishing a consolidated price for shares and the extension of pre and post-trade transparency requirements to non-equity and equity-like instruments.

Because under the current MiFID trade information transparency regime, pre-trade and post-trade transparency obligations are applicable to regulated markets, MTFs and systematic internalisers thereon shares admitted to trading on regulated market, consultation proposes to extend the transparency requirements to non-equity instruments, as well as to include following equity like financial instruments (admitted to trading on a regulated market) to the scope of

⁴⁰ Ibidem sect. 2.2.

transparency obligations: depositary receipts; exchange traded funds and certificates issued by companies⁴¹.

7.3. Regulation of Regulated Markets and MTFs

The MTFs are in some cases subject to a lighter and softer regulatory regime than regulated markets that led to imbalance in on the market of investment services providers. Thus being in line with CESR's Technical Advice the Consultation brought up a proposal to balance the organisational requirements for regulated markets and MTFs. This will mean that regulated markets and MTFs operating similar businesses will be subject to regulatory supervisions and equivalent organisational standards.

7.4. Automated trading

The automated trading is defined as the use of computer programmes to enter trading orders where the computer algorithm decides on aspects of execution of the order such as the timing, quantity and price of the order. A specific type of automated or algorithmic trading is known as high frequency trading (hereinafter in the text HFT)⁴². Outstanding changes of the market structure led to the fragmentation of the European financial instruments market, in turn, that significantly has increased the volume of HFT used by equity traders. The application of the HFT strategies provides greater liquidity on different trading venues and that directly affects the efficiency of shares price formation. HFT has increased dependency on complex technical systems. In order to stabilize and improve HFT functioning mechanism the Consultation proposing a set of requirements on firms involved in automated trading to put in place robust risk controls to mitigate potential trading errors. Trading venues operators also will comply with a range of requirements to ensure that automated trading errors should not interrupt the normal functioning of HFT. Alterations will engage all persons involved in high frequency trading (over certain threshold). The Consultation has formulated a proposal to authorise mentioned above persons as investment firms, namely those persons will be a subject of strict regulatory requirements addressed to investment firms.

⁴¹ Ibidem sect. 3.2

⁴² Ibidem sect. 2.3

CONCLUSIONS:

Summing up discussed information, I did following conclusions:

1. MiFID provisions should ensure the best execution for investors: according to the optimal performance conception investment firms should make a maximum effort to achieve the best possible result of the price, cost, speed of processing and feasibility. However, this key area of MiFID notably requires a modification and removal of shortcomings. For instance, Equiduct showed that of the €97 billion trades completed in January 2009 across the most liquid 500 stocks, a third (33.4%) could have achieved a better price on a different venue. Thus this data doesn't indicate the best execution.⁴³

2. Established by MiFID European passporting regime is favorable as for financial intermediaries as well as for investors. European passporting regime ensures a broader choice of financial instruments for Lithuanian investors, also provoked greater competition among investment firms in Lithuanian market reduced costs that incur investors in the process of purchasing of certain investment products or services.

3. Created by MiFID European financial markets environment brought massive alterations in Lithuanian market structure. Provoked greater competition along with financial innovations has affected all participants of Lithuanian financial instruments markets': from experienced intermediaries till inventors-dilettantes.

4. MiFID regime grants a greater level of protection and better services to Lithuanian investors, upon condition that firms providing investment services in each case should individually classify client, previously appraised client's experience and knowledge and in investment field, risk tolerance level and other principal factors. In turn, the Consultation requires that investment firms act honestly, fairly and professionally and to be fair, clear and not misleading in relation to eligible counterparties. Thereby the Consultation has balanced experienced eligible counterparties with more vulnerable retail and professional clients.

5. MiFID regime is a stride toward investors, in terms of better service, better prices and greater transparency.

⁴³ Chris Skinner, 'Is MiFID working' (The Financial Markets Network, 27 January 2010), <<http://www.finroad.com/articles/ismifidworking.html>> accessed 29 August 2011

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