On the Existence of a Pan-European Reverse Solicitation Regime under MiFID II, and Its Importance Following Brexit

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Abstract

This article addresses the legal basis and extent to which financial institutions outside the European Economic Area (EEA) may access customers on the basis of so-called reverse solicitation. It is argued here that reverse solicitation is a pan-EU legal construct subject to only limited national gold-plating discretions. Some of the practicalities for institutions relying upon this construct are discussed.

This article concerns a highly technical point of considerable practical importance. It challenges aspects of the received wisdom that, for post-Brexit cross-border investment business conducted from the UK into the EU27, a Member-State-by-Member-State analysis on perimeter issues needs to be undertaken in which only national law questions are relevant and in which no reference may be made to European legislation. In our experience, such exercises can produce unsatisfactorily vague outcomes in terms of local law analysis. Some local counsel analysis (and pronouncements from EU27 regulators) can be equivocal in addressing the possibility that client relationships established on the basis of "reverse solicitation" (i.e. at the client's own exclusive initiative) might lawfully be serviced from the UK. This situation has sometimes resulted in compliance teams and senior management of financial institutions determining that a low-risk approach to Brexit contingency planning necessarily involves the relocation of certain businesses, and the linked relocation of employees out of the UK to designated EU27 hubs.

The perceived notion that reverse solicitation issues are a national law matter is open to question, as explained below. This insight might at first appear insignificant, but it is critically important. European directives can of course be gold-plated and subject to local differences in implementation. However, if "reverse solicitation" is a priori a pan-EU concept, then local counsel or EU27 regulators would need to demonstrate the existence of constitutionally-adopted local "gold-plating" laws, regulations or other binding regulatory guidance which either disapplies or supplements the pan-EU provisions, if they are to have a supportable argument that business cannot practically be done on the basis of a reverse solicitation but will instead result in regulatory enforcement action being taken against the service provider.

Some EU27 national legal systems prescribe helpful detail as to how and when reverse solicitation may be applied and indeed some Member State laws provide for quite wide-ranging reverse solicitation regimes. More difficult issues tend to arise in respect of advice from the Member States with smaller financial markets, which may lack a detailed national regulatory perimeter regime. In our experience, few, if any, EU27 countries have laws that purport expressly to disallow reverse solicitation as a method to access local investors or which establish a catch-all category that covers all services and activities of third-country providers established, including outside the EU or the Member State itself. It is, however, often in those countries that advice on the regulatory perimeter is most equivocal and troublesome. To the extent that "reverse solicitation" is a pan-EU concept rather than a local discretion, pathways to continuing servicing existing clients in such countries post-Brexit become more predictable.

In previous articles, we have referred to the importance of considering reverse solicitation in Brexit contingency planning.[1] The practicalities and recommended compliance processes arising from this legal concept can be business- and organization-specific and are not touched upon in detail here. This article instead aims to focus on the critically important point of whether or not reverse solicitation starts life as a pan-EU concept or is merely a matter for national discretion since, if it is pan-EU, the general procedures for compliance that have been outlined should be reliable.

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[1] See, e.g. Shearman & Sterling LLP Client Notes, "Brexit Contingency Planning in Financial Services: Have All the Angles Been Considered?" (16 March 2018) and "Continuity of Contracts and Business on a 'Hard' Brexit: Human Rights and Reverse Solicitation to the Rescue!" (31 October 2017).

The concept

The European regulatory perimeter and reverse solicitation

Reverse solicitation is a concept pursuant to which EU businesses may reach outside the EU and acquire services and products from non-EU businesses. In doing so, EU customers may bypass or give up all or certain public law or regulatory protections afforded by their national or EU laws or regulations, effectively deciding instead that the third-country regulatory requirements applicable to the service provider, supplemented by any bespoke contractual arrangements, are sufficient. The Markets in Financial Instruments Directive (MiFID II) and the Markets in Financial Instruments Regulation (MiFIR)[2] both include express provisions on reverse solicitation. The Recitals to the Alternative Investment Fund Managers Directive (AIFMD)[3] preserve the pre-AIFMD position whereby an EU professional investor may invest in AIFs on its own initiative, regardless of where the AIFM and/or the AIF is established. This article discusses the MiFID II reverse solicitation regime in detail. We do not comment further on the AIFMD regime.

Many UK businesses need to provide at least some elements of their services to EU27 customers in reliance upon EU27 regulatory perimeter regimes (such as reverse solicitation) post-Brexit. This will be so for many firms at least to some degree, since they will not be able to offer their full suite of services from EU27 locations. In particular:

- It will often make little commercial or risk sense for EU27 customers to procure services that involve access to bank balance sheets, such as deposit-taking, proprietary market dealing, derivatives, lending and clearing member services, from thinly capitalised EU27 hubs of UK institutions.
- Until the investment firm review reforms[4] in this area come into force in June 2021, several financial institutions active in Europe are structuring their operations in such a way that EU27 hubs will have a more active role in marketing, trading, execution and non-balance sheet activities, before then introducing their clients to the UK head office for purposes of balance sheet activities. Such structures necessarily involve some aspect of reverse solicitation structuring.
- EU27 customers will likely still want to transact with UK clearing members when accessing UK market infrastructure if they wish to avail themselves of insolvency law protections such as account segregation, porting and so on, which (in contrast to the UK position for EU central counterparties (CCPs)) are often not available under EU national laws for third-country infrastructure.[5]
- For smaller firms or firms with small numbers of EU27 clients, the costs of establishment of an EU27 hub can outweigh the benefits. Several such entities' Brexit strategy involves either making reverse solicitation work or terminating their EU27 clients.[6]
- In addition to these quite specific use cases, it is likely that many EU27 customers will still want to reach out to UK providers to obtain the best pricing and the widest possible array of services from the most diverse and liquid financial markets in their timezone, located in the UK.

Reverse solicitation and other aspects of the European regulatory perimeter are similarly a critical issue for US, Asian and other firms from around the world, governing their daily interactions with EU counterparties and customers. This is not a new development. However, increased focus and regulatory attention is placed on the concept as a result of Brexit.

One absolutely fundamental question to be considered in interpreting the EU's reverse solicitation provisions is whether they have a pan-EU meaning, with consistency and clarity in their application, and if so, when. In our view, there are good arguments that reverse solicitation is a pan-EU concept, restricting the ability of EU27 regulators to prosecute third-country institutions that rely upon it. Such prosecution risks, which may sound fanciful,

[2] Directive 2014/65 on markets in financial instruments [2014] OJ L173/349 and Regulation 600/2014 on markets in financial instruments [2014] OJ L173/84.
[3] Directive 2011/61 on Alternative Investment Fund Managers [2011] OJ L174/1.
[4] The EU investment firm review reforms are contained in Regulation 2019/2033 on the prudential requirements of investment firms [2019] OJ L314/1 and Directive 2019/2034 on the prudential supervision of investment firms [2019] OJ L314/64, which establish the EU's new prudential regime for investment firms, but which include changes to the EU's MiFID II third-country access regime.
[5] EMIR (Regulation 648/2012 on OTC derivatives, central counterparties and trade repositories [2012] OJ L201/1) was recently amended (see art.39(10) inserted as part of EMIR 2.1 or EMIR REFIT (Regulation 2019/834 amending Regulation 648/2012 as regards the clearing obligation, the suspension of the clearing obligation, the reporting requirements, the risk-mitigation techniques for OTC derivative contracts not cleared by a central counterparty, the registration and supervision of trade repositories and the requirements for trade repositories [2019] OJ L141/42)) to provide insolvency law protections for EU CCPs. However, this does not apply to third-country CCPs. This means that UK CCPs with EU clearing members will not generally be able to carry out "porting" of margin and leapfrog payments upon an EU clearing member default. Third-country, including UK, CCPs are unlikely to be able to offer all the protections of clearing to customers of many EU27 clearing members without changes to EU27 insolvency laws. Where EU27 customers hold their positions though UK clearing members, this issue is avoided and all the benefits of EMIR in relation to clearing for customers would be available.
[6] Recent steps have been taken by some EU27 countries to mitigate this risk of reduced customer choice by permitting cross-border licences. However, this is not available on a pan-European basis. Experiences of multiple licensing of businesses on an EU/US basis is that this set-up can be stifling of business, in that new product launches and other matters that require multiple regulatory approvals or review can be subject to considerable delays. Furthermore, locally regulated firms tend to be prioritised by their own regulators in terms of resources and time, potentially having deleterious impacts on product development and competitiveness of firms subjecting themselves to such regimes.

are ultimately the main underlying concern that compliance teams and senior management of non-EU firms need to address.

As Brexit got closer to the wire, several EU27 Member States started developing more facilitative structures such as temporary permission regimes, temporary amnesties and cross-border licences. Local counsel advice is clearly helpful on these issues. Nonetheless, various major Member States, notably France, have not taken any such steps, meaning that reverse solicitation will still need to be considered, and could be helpful.

The existence of a pan-EU reverse solicitation concept matters, because it would reduce the need for firms to interact so intensively with a multiplicity of local advisers as to the precise application of perimeter laws. If the starting point is that there is actually such a thing as a general EU27 approach to reverse solicitation, then firms' legal and compliance resources can be focused on identifying instances of local gold-plating, more detailed implementation models (or even, if they exist, disapplications of the concept), paving the way for more consistent and coherent EU27 customer access models.

The tradition of open and closed markets

The EU is currently made up of 27 countries, some of which have had very different historical approaches to the regulatory perimeter.

One approach to third-country business—adopted by the UK, the Republic of Ireland and, to a lesser extent, Luxembourg—is to provide for generally open wholesale markets, in which cross-border transactions may take place with third-country entities, without the state imposing local licensing requirements. This approach differs from reverse solicitation regimes in generally legitimising all institution-to-institution cross-border business, including where marketing has taken place by the third-country firm. This was also the UK's philosophy when it was an EU Member State.

By contrast, many other EU Member States have legislated for more "closed" financial markets, in which local clients, and even some of their largest universal banks, may only access third-country financial institutions on a "we'll call you" basis—or so-called "reverse solicitation".

Origins in German and other laws and interpretational practices

Prior to the adoption of MiFID II (and, indeed, its precursor MiFID I),[7] several Member States developed laws, regulations or interpretations specifying when investment services or activities will be deemed to take place outside the territory of the Member State and when they would be subject to local licensing requirements. One of these is the idea that if services or activities are solicited by the client and not by a third-country service provider (a so-called "reverse solicitation" or "reverse enquiry"), then the service provider would not need local regulation. This concept was particularly developed in Germany and to a certain extent in France. In the UK, "solicited communications" constitute one of many means whereby local marketing rules may be satisfied by third-country firms accessing wholesale market participants.[8]

Many jurisdictions also have more detailed local retail or consumer protection schemes or other regimes which apply when individuals deal with third-country institutions. Examples include the UK's financial promotions regime, Germany's exemption regime based on equivalence and some French language requirements. Some of these regimes, if they derive in whole or in part from the regulation of services or activities prescribed under MiFID II, might be regarded by local lawyers as being outside the scope of MiFID II. However, they might alternatively be interpreted as involving a national accretion to the minimum regulatory net prescribed in MiFID II, in the same way as the activity of "arranging" in the UK encompasses more than merely "reception and transmission of orders" under MiFID II.

The freedom to receive services

The concept of reverse solicitation, as it exists under MiFID II and MiFIR, has been modelled on the so-called "passive" freedom to provide services (also called the "freedom to receive services"). This is a long-established principle deriving from the treaties[9] aimed at increasing the service choices of EU persons and improving competition within the single market. EU persons based in one Member State are entitled to request services from providers based in another Member State that may not otherwise be available from local providers. Similarly, reverse solicitation under MiFID II was introduced primarily to protect and further the interests of EU users of financial services offered outside of the EU. It should always be borne in mind that the regime is not intended to confer legal rights or business opportunities on third-country firms, although it has such an indirect effect.

MiFID II and the related legislative process

The MiFID II package, which became effective on 3 January 2018, comprises a directive (MiFID II) and a regulation (MiFIR), together with various technical standards and other pieces of subordinate legislation. It aims to further harmonise laws across the EU relating to brokerage, dealing, investment advice, portfolio management, alternative trading platforms, some aspects of custody, market-facing activities as well as regulatory reporting and some aspects of third-country access.

[7] Directive 2004/39 on markets in financial instruments [2004] OJ L145/1.
[8] Articles 8, 12, 30 and 36 of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (SI 2005/1529).
[9] *Luisi v Ministero del Tesoro* (286/82 and 26/83) EU:C:1984:35; [1985 3 C.M.L.R. 52.

In the original MiFID II proposal, the European Commission attempted to establish an entirely harmonised EU regulatory perimeter for investment business, based only on reverse solicitation or Commission equivalence determinations.[10] The proposal also included a mandatory branch requirement, in which Member States had to force third-country institutions accessing their retail markets to establish local branches. These "third-country provisions" proved to be among the most controversial ones during the passage of the legislation. From a UK perspective, one of the main pillars of the City of London's success—the overseas persons exclusion—was under threat as a result of this proposal.

The near-final provisions of MiFIR were amended substantially during the last trilogues in early 2014, primarily with the lead of the Council, following the presentation of packages on third-country issues by the Presidency. The final texts, especially the provisions around equivalence and national perimeter regimes in MiFIR, represented a compromise between those Member States that operated open markets under an overseas person exclusion and those with comparatively more closed markets. Essentially, open regulatory perimeters were ultimately allowed to co-exist under national laws with more closed national regimes only until such time as equivalence was declared for a particular country, from which point only reverse solicitation would co-exist with equivalency. In addition, the branch registration requirement became an optional regime for Member States to supplement if they so wished, which in practice few have exercised. In contrast, the provisions aimed at harmonising reverse solicitation at EU level barely changed between the Commission proposal text and the final legislative text. This history, detailed further in the analysis below, is critical to informing a proper interpretation of the relevant provisions but has been overlooked by some commentators.

The post-Brexit political and regulatory climate

Brexit has refocused attention on reverse solicitation and has subjected the relevant provisions of MiFID II and MiFIR to an unprecedented level of technical scrutiny. At the same time, it is reported that some Member State and EU authorities have sought to construe the concept narrowly in the hope of forcing business relocations. In the "investment firm review" of MiFID II[11] and related EU legislation, which is widely regarded as a Brexit-related legislative package in all but name, the possibility of using reverse solicitation is to be constrained even further from 26 June 2021.

Notably, the European Commission's "Brexit Preparedness Notices", published in February 2018,[12] emphasised the need for UK firms to invest in new EU27 companies and obtain new EU27 licences to continue servicing EU27 customers. These papers omit to mention the possibility of firms relying on available exemptions at European or national level. Separately, the European Securities and Markets Authority warned national regulators in the EU27 countries to ensure that third-country firms that are providing investment services to EU customers do so in compliance with the MiFID third-country regime and consider whether such third-country firms misuse the "clients' own exclusive initiative" exemption.[13]

The Commission issued updated Brexit Preparedness Notices in July 2020. Notably, in the Notice concerning banking and payment services, the Commission added that EU customers could maintain UK bank accounts with UK-authorised banks. One explanation for this is that the Commission continues to recognise characteristic performance,[14] which provides that the applicable regulatory regime is determined by reference to location of the "characteristic performance" of the service and deems a service to be provided where the essential supply of the service for which payment is due takes place.

Despite these significant political and policy developments, the relevant law, MiFID II has not changed since it was published in 2014. These and other steps in the regulatory and policy-making arena have, however, facilitated the development of a novel and narrow interpretation of reverse solicitation. Although MiFID II's effective date did not take place until well after the Brexit referendum, it was analysed by legal and compliance teams and regulators for implementation purposes for some time prior to this. To our awareness, more narrow interpretations of the reverse solicitation concept appear to post-date the Brexit referendum, and some support for this can be gleaned from a review of contemporaneous law firm client notes. We argue below that such narrow interpretations are questionable. However, to make the positive case for a pan-European reverse solicitation regime, it is necessary first to consider the rationale for a narrow interpretation.

[10] Proposal for a Directive on markets in financial instruments repealing Directive 2004/39 COM(2011) 656 final.
[11] Article 63 of Regulation 2019/2033 includes changes to art.46(5) of MiFIR and art.64 of Directive 2019/2034 includes changes to art.42 of MiFID II.
[12] See, e.g. European Commission, "Notice to Stakeholders: Withdrawal of the United Kingdom and EU Rules in the Field of Markets in Financial Instruments" (8 February 2018); European Commission, "Notice to Stakeholders: Withdrawal of the United Kingdom and EU Rules in the Field of Banking and Payment Services" (8 February 2018); and European Commission, "Notice to Stakeholders: Withdrawal of the United Kingdom and EU Rules in the Field of Asset Management" (8 February 2018).
[13] European Securities and Markets Authority (ESMA), "Opinion to support supervisory convergence in the area of investment firms in the context of the United Kingdom withdrawing from the European Union", ESMA35-43-762 (13 July 2017).
[14] Commission Interpretative Communication on Freedom to Provide Services and the Interest of the General Good in the Second Banking Directive, SEC(97) 1193 final and Commission Interpretative Communication on the Freedom to Provide Services and the General Good in the Insurance Sector [2000] OJ C43/5.

The narrow interpretation

Article 46(5) of MiFIR[15] establishes an exemption from the need for registration with the European Securities and Markets Authority (ESMA) (detailed further in Recital 43 of MiFIR)[16] for firms that deal with customers on a reverse solicitation basis. Supporters of the narrow interpretation note that this provision only applies following the adoption of an equivalence decision by the Commission and is otherwise inapplicable. No equivalence determinations yet exist under this provision, ergo, under the narrow interpretation, art.46(5) of MiFIR is not yet activated and cannot establish a pan-EU reverse solicitation regime. This interpretation is supported by art.1 para.(1)(f) of MiFIR,[17] which provides that the regulation's requirements in relation to third-country firms apply only "following an applicable equivalence decision". Article 1(5) of MiFIR contains similar restrictions.[18]

Separately, art.42 of the revised MiFID II provides that where a Member State exercises its discretion to require third-country firms providing investment services to establish a branch, the reverse solicitation exemption can be used to exempt third-country firms from the branch requirement.[19] In practice, few Member States have exercised their discretion to force the establishment and licensing of a local branch. Under the narrow interpretation, where a Member State does not exercise the "branch option", the reverse solicitation exemption in art.42 of MiFID II is also a provision that has not been activated.

Under this narrower interpretation, Recital 111 of MiFID II and Recital 43 of MiFIR, which are discussed further below, only relate to the territorial scope of the provisions of MIFID II and MiFIR which specifically deal with third-country firms, namely the branch requirement under MiFID II (where Member States decide to implement this requirement)[20] and the registration requirement under MiFIR (once triggered by an equivalency determination). This is on the basis that, except for the harmonised rules in Ch.IV of Title II of MIFID II and Title VIII of MiFIR, both MiFID II and MiFIR are silent on third-country firms, implying that all other aspects of third-country regimes are a discretion and autonomous matter for individual Member States and were not harmonised under the MiFID II package. The first sentence of art.5(1) of MIFID II, which establishes the licensing requirement for investment services and activities, is discussed in more detail below under the broad interpretation. Under the narrow interpretation, that provision applies only to investment firms (i.e. EU headquartered institutions), consistent with art.1(2)(a) of MiFID II, the following sentences of art.5(1) and the remaining paragraphs of that section and chapter.[21]

These arguments on the limited role of art.46(5) of MiFIR and art.42 of MiFID II are, in our view, entirely supportable. However, the limitation in scope of Recital 111 and, in particular, its exclusion from relevance to art.5(1), can be subject to alternative interpretations, which are discussed in the next section.

The case for a pan-European reverse solicitation regime

The broader interpretation holds that other operative provisions of MiFID II (beyond art.42) should be construed in light of Recital 111, in accordance with

[15] Article 46(5) of MiFIR states: "Member States shall ensure that where an eligible counterparty or professional client within the meaning of Section I of Annex II to Directive 2014/65/EU established or situated in the Union initiates at its own exclusive initiative the provision of an investment service or activity by a third-country firm, this Article does not apply to the provision of that service or activity by the third-country firm to that person including a relationship specifically related to the provision of that service or activity. *Without prejudice to intragroup relationships, where a third-country firm, including through an entity acting on its behalf or having close links with such third-country firm or any other person acting on behalf of such entity, solicits clients or potential clients in the Union, it shall not be deemed to be a service provided at the own exclusive initiative of the client.* An initiative by such clients shall not entitle the third-country firm to market new categories of investment product or investment service to that individual." (Italicised text shows the changes made by the Investment Firms Regulation (IFR), coming into effect on 26 June 2021.)

[16] Recital 43 of MiFIR states: "The provisions of this Regulation regulating the provision of services or undertaking of activities by third-country firms should not affect the possibility for persons established in the Union to receive investment services by a third-country firm at their own exclusive initiative or for Union investment firms or credit institutions to receive investment services or activities from a third-country firm at their own exclusive initiative or for a client to receive investment services from a third-country firm at their own exclusive initiative through the mediation of such a credit institution or investment firm. Where a third-country firm provides services at the own exclusive initiative of a person established in the Union, the services should not be deemed as provided in the territory of the Union. Where a third-country firm solicits clients or potential clients in the Union or promotes or advertises investment services or activities together with ancillary services in the Union, it should not be deemed as a service provided at the own exclusive initiative of the client."

[17] Article 1 para.(1)(f) of MiFIR states: "This Regulation establishes uniform requirements in relation to the following: … (f) provision of investment services or activities by third-country firms following an applicable equivalence decision by the Commission with or without a branch."

[18] Article 1(5) of MiFIR states: "Title VIII of this Regulation applies to third-country firms providing investment services or activities within the Union following an applicable equivalence decision by the Commission with or without a branch."

[19] Article 42 of MiFID II states as follows: "Member States shall ensure that where a retail client or professional client within the meaning of Section II of Annex II established or situated in the Union initiates at its own exclusive initiative the provision of an investment service or activity by a third-country firm, the requirement for authorisation under Article 39 shall not apply to the provision of that service or activity by the third-country firm to that person including a relationship specifically relating to the provision of that service or activity. *Without prejudice to intragroup relations, where a third-country firm, including through an entity acting on its behalf or having close links with such third-country firm or any other person acting on behalf of such entity, solicits clients or potential clients in the Union, it shall not be deemed to be a service provided at the own exclusive initiative of the client.* An initiative by *such a clients as referred to in paragraph 1* shall not entitle the third-country firm to market *new categories of investment products or investment services to that client* otherwise than through the branch, where one is required in accordance with national law, *new categories of investment products or investment services to that client*." (Italicised and strike through show how this provision will read from 26 June 2021, as a result of the Investment Firms Directive (IFD).)

[20] Under the narrow interpretation, the same analysis would hold with regard to the corresponding Recital of the Commission's initial draft of MiFID II, which would then have referred only to the chapter on the branch requirement, which at that time was mandatory and lacked any explicit exception based on reverse solicitation in the operative provisions of the Directive.

[21] The term "investment firm" does not include a "third-country firm". Under art.4 para.57, the later term is defined as "a firm that would be a credit institution providing investment services or performing investment activities or an investment firm if its head office or registered office were located within the Union". In relation to the "provision of investment services or activities by third-country firms", art.1 para.2(b) of MiFID II clarifies that the Directive only deals with such services in Ch.IV of Title II of MIFID II to the extent that they are provided "through the establishment of a branch". The first sentence of art.5(1) contains no mention of investment firms. However, the second sentence of art.5(1) of MiFID II refers to investment firms, then uses the word "such" to refer back to the first sentence.

ordinary principles of EU law interpretation[22] and consistent with the *travaux préparatoires*. In particular, recitals on reverse solicitation and jurisdictional scope are relevant to interpreting art.5(1) of MiFID II (which establishes the base-line licensing requirement for regulated business) as well as the definitions of the various investment services and investment activities which are covered by MiFID II.

Scope of the MiFID II recitals; applicability to the authorisation requirement and definitions of investment services and activities

Recital 111 of MiFID II states:

> "The provision of this Directive regulating the provision of investment services or activities by third-country firms in the Union should not affect the possibility for persons established in the Union to receive investment services by a third-country firm at their own exclusive initiative. Where a third-country firm provides services at the own exclusive initiative of a person established in the Union, the services should not be deemed as provided in the territory of the Union. Where a third-country firm solicits clients or potential clients in the Union or promotes or advertises investment services or activities together with ancillary services in the Union, it should not be deemed as a service provided at the own exclusive initiative of the client."

On a natural reading, the Recital is broader than the narrow issue of branch registration requirements under art.42 of MiFID II. The first sentence references "the provision[s][23] of this Directive regulating the provision of investment services or activities by third-country firms", which is the wording in the title of Ch.IV of MiFID II (which contains art.42) but that does not preclude it from being used to interpret ambiguities in other provisions that regulate the provision of investment services or activities by third-country firms. In any event, even if the first sentence of the Recital were limited to Ch.IV, this does not necessarily limit the scope of the remainder of the Recital, which could still be used to resolve ambiguities elsewhere in the Directive.

The "broader interpretation" position is based on the argument that art.5(1) also ultimately contains an ambiguity which Recital 111 is necessary to resolve. Article 5(1) of MiFID II is the main provision establishing the licensing of investment services and activities, effectively the equivalent in a European context of s.19 of the Financial Services and Markets Act 2000, which is the UK implementation of this provision. Article 5(1) starts by providing that:

> "Each Member State shall require that the provision of investment services and/or the performance of investment activities as a regular occupation or business on a professional basis be subject to prior authorisation in accordance with this Chapter."

The relevant investment services and investment activities that are covered by this authorisation requirement are set forth in Annex 1 s.A of MiFID II and several of them are defined further in art.4. The territorial scope of the services and activities which are captured by this prohibition is not, however, specified either in art.5(1), Annex 1 or the art.4 definitions. Without more, art.5(1) would be an incredibly broad provision, potentially regulating the provision of investment services or performance of investment activities anywhere in the world, even where there was no EU customer or place of business involved.

In order to understand the territorial scope of art.5(1), it is necessary therefore to turn to Recital 7, which states that investment services must be provided "in the Union" in order to fall within scope of MiFID II. However, that Recital does not provide any detail as to what it means for a service or activity to take place "in the Union". In the context of cross-border investment services and investment activities, this is quite an important open question. In particular, an ambiguity remains, even after considering Recital 7, about how one can tell whether a service is provided "in the Union" when services are provided by a third-country firm to EU customers. Recital 111 provides a partial answer to that question by stating in its second sentence that: "Where a third-country firm provides services at the own exclusive initiative of a person established in the Union, the services should not be deemed as provided in the territory of the Union." The effect of this interpretation is that Recital 111 and Recital 7 together help interpret art.5(1) of MiFID II and the relevant list and definitions of investment services and activities to which it relates. Only services carried out in the EU require prior authorisation, and that will not be the case where a third-country firm provides services at the own exclusive initiative of a person established in the Union.[24]

[22] Under EU law, recitals can be taken into account to resolve ambiguities in the actual substantive provisions to which they relate, but they cannot have any autonomous legal effect (*Moskof v Ethnikos Organismos Kapnou* (C-244/95) EU:C:1997:551 at [44]–[45]). Recitals can also be used to establish the purpose of an operative provision (*R. (on the application of Broadcasting, Entertainment, Cinematographic and Theatre Union (BECTU)) v Secretary of State for Trade and Industry* (C-173/99) EU:C:2001:356 ; [2001] C.M.L.R. 7 at [37]–[39]) or the scope of that provision (*Re C (A Child)* (C-435/06) EU:C:2007:714; [2008] I.L.Pr. 1 at [51]–[52]).

[23] We note that the English version uses the word "provision" in the singular, whereas other language versions use the word "provisions" in the plural, see e.g. the French ("Les dispositions") and German ("Die Bestimmungen"). MiFIR also uses the term "provisions". Usage of the singular is therefore probably a typographical error.

[24] It has been counter-argued that art.5(1) and other parts of art.5 address registration requirements for locally (EU) established firms and not third-country firms. Usage of the word "such" in art.5(1) second sentence is helpful towards this analysis. Accordingly, it can be said that all of art.5(1) should be interpreted in that context. In our view, this is not a strong argument since almost all financial regulatory regimes start with a general prohibition on carrying on activities or providing services on an unlicensed basis, before then moving on to address the issue of how local firms obtain a licence. For example, the UK imposes a general prohibition against the performance of regulated activities in the UK without authorisation under s.19 of the Financial Services and Markets Act 2000 and then deals with requirements for UK firms applying for authorisation under following provisions in arts 31–55. MiFID II is not novel in this respect.

Under this view, Recital 111 would continue to be relevant even if third-country access provisions in Ch.IV did not exist. The operative provisions on reverse solicitation in art.42 of MiFID II (and art.46(5) of MiFIR) are necessary only to address specific conflicts with different operative provisions that would otherwise arise, namely whether (in the case of art.42 of MiFID II) the exercise by a Member State of the branching requirement expunges all other routes to providing services to EU clients (it does not); or (in the case of art.46(5) of MiFIR), whether following an equivalence decision, a third-country firm could only provide services to EU clients if it is registered in the register of third-country firms kept by ESMA (that is not the case). In other words, these provisions simply "keep alive" the permissibility of a third-country firm providing services at the own exclusive initiative of an EU firm without prior authorisation under art.5(1), as interpreted by Recital 111.

Consistency with legislative history

The broad interpretation is consistent with the legislative history of MiFID II. The wording of Recital 111 was included in the original European Commission MiFID II proposal,[25] at a time when there was no operative reverse solicitation provision or wording of the form or kind included in the final art.42. Article 42 was first proposed as a Council amendment to MiFID II and was introduced into the final text in late 2014 after a third attempt at trilogues, following two unsuccessful rounds on the topic which both resulted in the provision being pended as open. The text of Recital 111 changed in minor ways between the Commission proposal and final version of MiFID II but these were only to address minor drafting developments and improvements, for example, reflecting the concepts of both investment services and investment activities. Recital 111 was neither removed nor put back into iterations of MiFID II drafts whilst art.42 was proposed by Council, proposed for non-inclusion by Parliament or non-agreed at trilogue stage. Any interpretation of Recital 111 which limits its scope to art.42 cannot therefore logically be sustained since Recital 111 pre-dates art.42 in the history of this legislation and existed without art.42, so must be relevant to something else. In our view, that "something else" includes art.5(1) and the definitions of investment services and investment activities.

Furthermore, the more recent legislative history of the Investment Firms Directive (IFD) and Investment Firms Regulation (IFR) supports a broader interpretation. The original Commission IFR proposal did not contain any amendments to the MiFID II or MiFIR reverse solicitation provisions.[26] The changes to art.46of MiFIR were inserted in January 2019 by the Council and the text was not materially changed as the proposals were debated.[27] The points made in this article have been well known in the market during the passage of IFR and IFD, not least given that we first published an earlier version of this article on 19 February 2019. However, no attempt was made by the EU to restrict the reverse solicitation provisions, either in accordance with ESMA's recommendations to the Commission in September 2018 (see below) or otherwise.

Consequences of the broader interpretation and possible conflicts with national laws

Under this broader interpretation, any EU Member State that purports to require local licensing for the provision of investment services or performance of investment activities by third-country firms on a reverse-solicitation basis would not have established such requirements under the auspices of MiFID II or MiFIR. That is not to say that such a requirement would be unlawful: Member States are not restricted from gold-plating the MiFID II package under national law frameworks nor from prescribing additional detail. However, in our view, express national laws, regulations or binding regulatory guidance concerning how and when relevant third-country investment services or activities are to be regulated, that have been constitutionally adopted under national laws, would be required to disapply the reverse solicitation concept established at the EU level under MiFID II and MiFIR. Such a disapplication of reverse solicitation could be done within the drafting of the provision that implements art.5(1) or specified by national regulators under general administrative law powers, but such items must at least exist for them to have legal force.

The need for a Member State to identify expressly contradictory national laws to disapply the reverse solicitation concept is important since such laws are elusive in practice, facilitating more consistency in EU-wide approaches in this area. This approach can be relied upon because of the "indirect effect" of European directives. "Indirect effect" is an EU law principle that requires Member States to interpret national laws in conformity with EU laws as far as possible, and must attempt to reconcile provisions of national laws with those of an EU directive so as to achieve the purpose of the directive.[28] This is also known as the "interpretative obligation". The interpretative obligation and indirect effect would not, however, apply where a Member State's law and EU directive are in direct conflict.[29]

[25] Proposal for a Directive on markets in financial instruments repealing Directive 2004/39 COM(2011) 656 final. The original draft of Recital 111 was present in the form of Recital 74 in the original Commission proposal.
[26] Proposal for a Regulation on the prudential requirements of investment firms and amending Regulations 575/2013, 600/2014 and 1093/2010 COM(2017) 790 final; COD(2017) 359.
[27] Proposal for a Regulation on the prudential requirements of investment firms and amending Regulations 575/2013, 600/2014 and 1093/2010—Presidency compromise proposal, ST 5021 2019 INIT (4 January 2019).
[28] See *Von Colson v Land Nordrhein-Westfalen* (C-14/83) EU:C:1984:153; [1986] 2 C.M.L.R. 430.
[29] In *Miret v Fondo de Garantia Salarial* (C-334/92) EU:C:1993:945; [1995] 2 C.M.L.R. 49, the European Court of Justice (ECJ) recognised that the national court could not interpret the national law in conformity with the relevant directive.

The MiFID II package may be expressly gold-plated in national laws, as the UK did in its regulation of the activity of "arranging"[30] which is wider than the corresponding activity of "receiving and transmitting orders"[31] under MiFID II. A national gold-plated requirement (supplementing MiFID II's third-country provisions so as to outlaw or restrict third-country business on a reverse solicitation basis) would need to be more than mere regulatory opinion, policy thinking or private communication since it would need to be binding under the constitutional law of the Member State concerned to defeat the doctrine of indirect effect.

It is also open to Member States to prescribe further detail as to the operation of the reverse solicitation provisions of MiFID II in a manner which is consistent with the Directive (and if it goes beyond that, then it would fall in a gold-plating category). More detailed regimes may, however, need to be monitored and reviewed in light of EU developments.

ESMA is tasked with "contributing to the consistent application of legally binding Union acts, in particular by contributing to a common supervisory culture" and "ensuring consistent, efficient and effective application of legal acts including MiFID II".[32] One of the means available to ESMA to promote convergence across the EU is through Questions and Answers (Q&A).[33] ESMA's Q&A on investor protection issues[34] include "Answers" on the application of the reverse solicitation provisions under MiFID II and MiFIR. ESMA has also made recommendations to the Commission on how the reverse solicitation exemption in MiFID II could be developed, including by requiring firms to provide evidence of a client's initiative, clarifying that reverse solicitation involving certain clients should be assessed on a transaction-by-transaction basis and considering the scope of the term "new categories of investment products and services".[35] More recently, in January 2021, ESMA issued a public statement[36] following what it describes as "questionable practices" materialising after the end of the Brexit transition period, where firms have purported to opt clients into "reverse solicitation" through either generic terms and conditions amendments or click-through "I agree" boxes online. It is clear from this statement that ESMA's view is that more is needed than this to invoke the reverse solicitation regime. Notably, ESMA does not criticise more robust reverse solicitation protocols that are seen in the market, such as a termination notice by the UK service provider of the existing agreement, sometimes with a covering note that the client could at its initiative reach out afresh to request entry into a new agreement should it so desire. It is unlikely that ESMA would have taken these steps (i.e. publishing the Q&A, recommendations and statement) unless it had good grounds for concluding that reverse solicitation constitutes a genuine pan-European framework. If there is no such pan-European framework (as argued by supporters of the narrower view), it would be a national law question over which ESMA has no competence. The steps taken by ESMA are based upon the view that reverse solicitation is an EU-wide concept on which ESMA is expressly charged with providing guidance.

Conclusions

For the reasons above, there are good arguments that reverse solicitation under MiFID II can be regarded as a pan-European concept which takes root in EU27 national laws by virtue of indirect effect and the interpretative obligation. This analysis now seems at least tacitly to have been accepted by ESMA, as a result of its apparently EU-wide recent pronouncement on the topic. Member States may of course add to that concept by way of expressly gold-plating MiFID II. It is important when obtaining local legal advice on the regulatory perimeter, especially for countries that have implemented MiFID II only by way of copy-out, to ensure that advisers consider the broader interpretation and indirect effects of European directives.

Clearly, any UK (or other third-country) business that relies on reverse solicitation strategies needs to be based upon careful compliance processes and good documentation. According to ESMA, any means of marketing to new EU27 clients is not possible under reverse solicitation, including such as press releases, advertising on internet, brochures, phone calls (including cold-calling) or face-to-face meetings.[37] However, certain business leaders, depending on their EU27 footprint, revenues and opportunities, may determine that reliance upon reverse solicitation, including imposing the necessary marketing restrictions, is a price worth paying for additional time whilst clarity on the post-Brexit regulatory environment develops.

We hope that the issues raised in this article will assist the financial industry, regulators and legal advisers in considering whether, and the extent to which, "reverse solicitation" exists as a pan-European MiFID II concept. We also hope that these insights will facilitate a more rational and consistent analysis of cross-border business conducted into the EU and its knock-on effects on businesses and livelihoods.

[30] Article 25 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (SI 2001/544).
[31] MiFID II Annex 1 s.A.
[32] Regulation 1095/2010 establishing a European Supervisory Authority (European Securities and Markets Authority) [2010] OJ L331/84 art.8(1)(b). It also has powers to publish guidelines and recommendations under arts 8(2)(c) and 16 of the same measure.
[33] Regulation 2019/2175 amending Regulation 1095/2010 Regulation, 1094/2010, Regulation 1095/2010, Regulation 600/2014, Regulation 2016/1011, and Regulation 2015/847 [2019] OJ L334/1. Recital 12 states: "Questions and answers are an important convergence tool that promote common supervisory approaches and practices by giving guidance on the application of Union legal acts within the scope of the ESAs."
[34] ESMA, "Questions and Answers on MiFID II and MiFIR investor protection and intermediaries", ESMA35-43-349.
[35] See ESMA's Letter to the Commission, ESMA35-36-1442 (26 September 2018).
[36] ESMA Public Statement, "Reminder to firms of the MiFID II rules on 'reverse solicitation' in the context of the recent end of the UK transition period", ESMA35-43-2509 (13 January 2021).
[37] ESMA Public Statement, "Reminder to firms of the MiFID II rules on 'reverse solicitation' in the context of the recent end of the UK transition period" (2021).