

**MFSA**

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**MALTA FINANCIAL SERVICES AUTHORITY**

**Guidance Notes**  
**to**  
**the Investment Services Rules**  
**for**  
**Investment Services Providers**

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## **GUIDANCE NOTES**

# **TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

## **INTRODUCTION**

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The **MiFID** which replaces the Investment Services Directive (will be repealed on the 1st November 2007) is a central element of the Commission Financial Services Action Plan. **MiFID** introduces a comprehensive regulatory regime covering investment services, trading platforms (including regulated markets, multilateral trading facilities and systematic internalisers) and financial markets in Europe and was formulated with the ultimate aim of opening up Europe's capital markets by improving the price transparency of traded financial instruments, while making it easier to execute trades across borders.

**MiFID** establishes a wide ranging authorisation requirement covering all the service providers mentioned above and sets: **(a)** rules regulating the operation/administration and conduct of business of investment firms; **(b)** pre/post transparency requirements applicable to trading platforms; **(c)** enhanced transaction reporting requirements and enforcement and exchange of information provisions. The **MiFID** also updates the 'single passport' for investment firms and extends the list of services (includes investment advice and the operation of an MTF) and financial instruments.

**MiFID** was adopted by the European Parliament and the Council of the European Union on the 21<sup>st</sup> April 2004. It is a framework directive under the Lamfalussy process which has been complemented with two implementing measures issued by the EC Commission in the form of one regulation and one directive as follows:

- (a)** Commission Regulation (EC) No 1287/2006 of 10<sup>th</sup> August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards record-keeping obligations for investment firms, transaction reporting, market transparency, admission of financial instruments to trading, and defined terms for the purposes of that Directive; and
- (b)** Commission Directive 2006/73/EC of 10th August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for investment firms and defined terms for the purposes of that Directive.

It is imperative to note that while Commission Directives require transposition in the legal framework of the Member State, Commission Regulations have direct effect and are, from the date they come into force, considered to form part of the legal framework of the Member State. Therefore, although the Commission Regulation mentioned above does not

require transposition, parties affected by the said Regulation are nonetheless required to abide by the rules established therein.

The MIFID and the implementing Commission Directive mentioned have been transposed by way of changes to the Investment Services Act, 1994, the Financial Markets Act, 1990, and the Regulations and Rules issued there under.

The effective date of the new legal and regulatory framework to comply with MiFID and its implementing directive is the 1<sup>st</sup> November 2007, by which date, Investment Services Licence Holders and Regulated Markets must have policies and procedures in place which implement these provisions.

## **Purpose**

The Malta Financial Services Authority (henceforth referred to as the 'MFSA') as competent authority for the purposes of the **Investment Services Act, 1994** and the **Financial Markets Act, 1990**, has the function of administering the said Acts.

The purpose of these Guidance Notes is to afford Investment Services Licence Holders with best practice guidance on the manner in which they may comply with a number of requirements set out in the MFSA's Investment Services Rules which have the purpose of transposing and implementing the MiFID.

Given that many of the Investment Services Rules are of general applicability and relevant for various types of Investment Services providers, and to avoid multiple regulatory regimes, unless otherwise stated, the MFSA will be applying such Rules to all Investment Services Licence Holders, irrespective of whether or not they fall within the scope of the MiFID. Accordingly, the licence conditions in the Rules should be implemented and complied with by **ALL Investment Services Licence Holders** irrespective of whether they qualify as a MiFID investment firm or not. This notwithstanding, it is pertinent to highlight that the extent to which the licence conditions in the Rules are applicable to any one Licence Holder, depends on the nature of licensable activity which a Licence Holder is authorised to provide. By way of example, as explained in MFSA's feedback statement dated 17<sup>th</sup> July 2007, the conduct of business rules apply to Fund Managers and Custodians of Collective Investment Schemes in the following manner:

**[A] Fund Managers and Custodians which are not licensed to provide any of the services listed in Section A of Annex 1 of the MiFID ('MIFID services') but are only licensed to provide custody or management services with or without the provision of nominee services for investors, are required to comply with the requirements included under the following sub-titles of Section 2 of the Rules entitled 'Conduct of Business':**

- General
- Client Reporting: Statement of Client Financial Instruments or Client Money (where applicable)

- Record keeping
- Safeguarding of Client Assets (where applicable)
- Conflicts of Interests
- Staff Dealing
- Provision of Services through the Medium of Another Licence Holder
- Conduct of Business Rules for Licence Holders Producing and Disseminating Investment Research (where applicable)
- Conditions applicable to the provision of information
- Complaints Handling

**[B] Fund Managers whose staff may be involved in the sale and promotion of funds managed by the said fund managers and in the receipt of orders directly from clients (not through a licensed intermediary) for subscribing to units in the funds concerned are also expected to comply with the following sub-titles of Section 2 in addition to the sub-titles indicated above:**

- Client Classification
- Client Profile Requirements: relating to the Assessment of Appropriateness
- Client Disclosure Requirements
- Provisions applicable to Licence Holders Whose Staff Promote and Sell Investment Product
- Transactions Executed with Eligible Counterparties

**[C] Fund Managers which are also licensed to provide a MiFID service (such as portfolio management and/or investment advice) are expected to comply with *all* the sub-titles of Section 2 of the Investment Services Rules.**

### **Source**

In preparing these Guidance Notes reference was made *inter alia* to the Committee of European Securities Regulators' Level 3 – Guidance, which guidance is accessible on CESR's web-site through the following web-address: <http://www.cesr.eu>

### **Disclaimer:**

As indicated above, these Guidance Notes are aimed at assisting Licence Holders interpret and comply with the Investment Services Rules and do not in any manner replace such Rules, which Licence Holders are bound to comply with.

**GUIDANCE NOTES**

**TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

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<sup>1</sup> When reading these Guidance Notes: Licence Holders should refer to the relevant Standard Licence Conditions ‘SLCs’ indicated, set out in Part B of the Investment Services Rules for Investment Services Providers issued by the MFSA in terms of the Investment Services Act, 1994.

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## GUIDANCE NOTES

### TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

#### GUIDANCE NOTE NO. 1

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#### General Requirements – [SLCs 1.01 – 1.29]

- [i] Section 1 of the Investment Services Rules contains requirements dealing with the organisational structure, and the compliance, risk management and internal audit functions of a Licence Holder. It also includes general notification requirements and requirements on the responsibility of senior management.
- [ii] Guidance Note No 1 deals with the standard licence conditions dealing with business continuity planning, and the standard licence conditions on the compliance, risk management and internal audit functions of a Licence Holder.

#### 1 [A] General Organisational Requirements – [SLCs 1.17 – 1.19]

SLC 1.18 *inter alia* provides that a Licence Holder should establish, implement and maintain an adequate business continuity process aimed at ensuring, in the case of an interruption to its systems and procedures, the preservation of essential data and functions and the maintenance of investment services and activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of its investment services and activities. **Guidance Note 1 [A] has the aim of giving the industry an indication of the business continuity process and the critical elements to be included in a business continuity plan.**

##### 1 [A.1] What is a business continuity process?

- [i] There are generally three components of a business continuity process: [a] the disaster recovery plan [‘DRP’]; [b] business continuity plan [‘BCP’]; and [c] business continuity management [‘BCM’].
- [ii] A DRP is a document that defines the resources (hardware, software, communications, data as well as human resource), actions and tasks required for the recovery of the infrastructure needed to support the Licence Holder’s business functions. The document would normally form part of the BCP



- [iii]** The BCP is a document defining the advance planning and preparations that are necessary to minimise loss and ensure continuity of the critical business functions of a Licence Holder in the event of disruption.
- [iv]** BCM is a management function the purpose of which is to identify potential threats which may affect a Licence Holder and to design a responsive framework to safeguard the Licence Holder's interests as well as that of its customers.
- [v]** BCM entails much more than simply producing a BCP. This is an ongoing management process which needs to take a proactive rather than reactive approach and give the necessary attention to the critical resources of an organisation (people, systems and other physical resources).
- [vi]** BCM encompasses BCP and DRP, integrating them into the strategic processes of the enterprise and is an integral part of corporate governance.

**1 [A.2] Business Continuity Management**

- [i] Depending on the nature, scale and complexity of a Licence Holder's business, the business continuity management team would normally be composed of the executive management, the BCP co-ordinator and the internal auditor.
  
- [ii] **In general the aim of a business continuity management team is that of:** [a] identifying and defining the critical resources [including key people] and functions of the Licence Holder's business; [b] defining a process to protect the Licence Holder's critical resources and functions; [c] defining alternatives for the continuation of critical functions; [d] preparing and documenting a business continuity plan [including the DRP] and a training program; [e] training personnel; [f] testing the BCP on a periodic basis; and [g] continuously reviewing and maintaining the BCP.
  
- [iii] Once drafted and finalised, the BCP would generally be endorsed by the Directors of the Licence Holder and implemented by the executive management.
  
- [iv] The custody of the BCP would normally be held by the Directors of the Licence Holder who would usually appoint an individual responsible for the overall co-ordination of the BCP – BCP co-ordinator.
  
- [v] The primary focus of a BCP co-ordinator is to oversee a viable and tested business continuity plan that demonstrates to management the Licence Holder's ability to continue critical business functions following a disruption of services. The BCP co-ordinator would generally also be responsible for: [a] the co-ordination of key personnel; [b] overseeing the identification and review of critical tasks that are essential during the recovery process; [c] establishing an ongoing training program to promote company-wide awareness of the recovery function; [d] establishing a time-table for regular review and updating of plans, resources and procedures to ensure that changes to critical procedures, functions and documentation are included in the plan; [e] co-coordinating quarterly and annual testing of the plan as needed and report the results thereof to the executive management; [f] keeping all personnel abreast as necessary with any changes; [g] maintaining contact with suppliers to assure support during a recovery effort; [h] acting as a point of liaison for contingency planning issues between information resources and other business units; [i] meeting on a regular basis with the recovery teams to review responsibilities required during a recovery effort; [j] maintaining contracts for alternate facilities and/or services; and [k] providing input for performance reviews of contingency planning.

- [vi] Should the Licence Holder avail itself of an internal audit function, the internal auditor should: [a] evaluate whether necessary controls were followed during an actual emergency; [b] report findings to executive management and the BCP co-coordinator; and [c] follow up its reports to ensure compliance with findings.

**1 [A.3] The Business Continuity Plan/Manual**

**[i]** A BCP is a management process to ensure the continuity of businesses. A completed BCP cycle results in a formal printed manual available for reference before, during, and after disruptions have occurred. Its purpose is to reduce adverse stakeholder impacts determined by both the disruption's scope (who and what it affects) and duration (how bad, implications last for hours, months etc). Measureable Business Impact Analysis (BIA) areas in which hazards and threats reside include civil, economic, natural, technical, secondary and subsequent.

**[ii]** The basic components of a good business continuity plan generally include: **[a]** planning and implementing the activities of prevention and protection of all of the risks anticipated before an event occurs; **[b]** planning for the activities to be implemented or executed during an emergency or disastrous event; and **[c]** strategic and tactical planning with resources, vital information and documentation of the activities for resumption, recovery, and restoration of businesses - both physical and logical, exercises/update and plan management.

**[iii]** The development of a BCP manual would normally include the following phases:

**(a)** Analysis:

The analysis phase in the development of a BCP manual consists of an impact analysis, threat analysis, and impact scenarios with the resulting BCP plan requirement documentation. Part of the analysis would need to specify a step-by-step approach of how the institution would have its operational activities up and running in the least possible time in the event of a major incident which would render its current offices inoperable. Such a plan would, *inter alia*, specify: **[i]** the objectives of the BCP; **[ii]** the BCP co-ordinator; **[iii]** key personnel required to help in the recovery process; **[iv]** clear lines of authority and substitutes; **[v]** telephone numbers of all the persons mentioned in the previous points; **[vi]** details of any agreement with third parties (if applicable) required to ensure resumptions of operations; **[vii]** contact details of third parties which may be essential to resumption of operations; **[viii]** an alternative site from which operations can be resumed; **[ix]** an outline of the main steps which should be taken to resume operations; **[x]** data back-up and recovery (hard and electronic copy); **[xi]** financial and operational assessments; **[xii]** communications with regulators; and **[xiii]** how the Licence Holder will ensure its customers' prompt access to their funds and securities in the event of non-continuation of

business.

**(b)** Solution design:

The goal of the solution design phase is to identify the most cost effective disaster recover solution that meets two main requirements from the BIA stage.

**(c)** Implementation:

The implementation phase, quite simply, is the execution of the design elements identified in the solution design phase. Work package testing may take place during the implementation of the solution, however; work package testing does not take the place of organizational testing.

**(d)** Testing, organization and acceptance:

The purpose of testing is to achieve organizational acceptance that the business continuity solution satisfies the organization's recovery requirements. Plans may fail to meet expectations due to insufficient or inaccurate recovery requirements, solution design flaws, or solution implementation errors.

**(e)** Maintenance:

Maintenance of a BCP manual is broken down into three periodic phases. The **first phase** is the [a] confirmation by directors of the information in the manual, [b] distribution of copies of such BCP to ALL members of staff for awareness; and [c] specific training for individuals whose roles are identified as critical in response and recovery. The **second phase** is the testing and verification of technical solutions established for recovery operations. The **third phase** is the testing and verification of documented organization recovery procedures. A biannual or annual maintenance cycle is typical.

**[iv]** A BCP manual for a **small organization** may be simply a printed manual stored safely away from the primary work location, containing the names, addresses, and phone numbers for crisis management staff, general staff members, clients, and vendors along with the location of the offsite [data backup storage media](#), copies of insurance contracts, and other critical materials necessary for organizational survival.

**[v]** At its most complex, a BCP manual may outline a [secondary](#) work site, technical requirements and readiness, [regulatory](#) reporting requirements, work recovery measures, the means to reestablish physical records, the means to

establish a new supply chain, or the means to establish new production centers. Firms should ensure that their BCP manual is realistic and easy to use during a crisis.

**1 [B] Compliance / Risk Management / Internal Audit**

**1 [B.1] Compliance– [SLCs 1.20 – 1.22]**

**[i]** SLCs 1.20 to 1.22 stipulate requirements dealing with the compliance function which a Licence Holder is required to satisfy. *Inter alia* SLC 1.22 requires a Licence Holder to ensure that:

- ◆ the relevant persons involved in the compliance function must not be involved in the performance of services or activities which they monitor; and
- ◆ the method of determining the remuneration of the relevant persons involved in the compliance function must not compromise the objectivity or must not be likely to do so.

**[ii]** The same SLC gives the MFSA the power to exempt a Licence Holder from the above- requirements if the Licence Holder is able to demonstrate to the satisfaction of the MFSA, that in view of the nature, scale and complexity of its business, and the nature and the range of investment services and activities, the requirement under that point is not proportionate and that its compliance function continues to be effective. Licence Holders wishing to obtain this exemption, must complete and send to the MFSA - Securities Unit the form attached as Appendix I to these Guidance Notes.

**1 [B.2]** *Risk Management – [SLCs 1.23 – 1.24]*

- [i]** SLCs 1.23 to 1.24 stipulate requirements dealing with risk management which a Licence Holder is required to satisfy. *Inter alia* SLC 1.24 requires a Licence Holder to establish and maintain a risk management function that operates independently and carries out the following tasks:

  - [a]** implementation of the risk management policy and procedures; and
  - [b]** provision of reports and advice to senior management on a frequent basis [at least annually].
  
- [ii]** The same SLC gives the MFSA the power to exempt a Licence Holder from the above- requirements if the Licence Holder is able to demonstrate to the satisfaction of the MFSA, that the establishment and maintenance of an independent risk management function is not appropriate and proportionate in view of the nature, scale and complexity of its business, and the nature and the range of investment services and activities, undertake in the course of that business. Licence Holders wanting to obtain this exemption, must complete the form attached as Appendix II to these Guidance Notes.



**1 [B.3]** *Internal Audit – [SLCs 1.28]*

- [i]** SLC 1.28 provides that depending on the nature, scale and complexity of the Licence Holder's business and the nature and range of investment services and activities undertaken in the course of its business, the Licence Holder shall establish an internal audit function. Licence Holders which do not intend to establish an internal audit function must complete the form in Appendix III to these Guidance Notes.

## GUIDANCE NOTES

### TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

#### GUIDANCE NOTE NO. 2

#### Conduct of Business Rules – [SLCs 2.03 – 2.145]

Section 2 of the Investment Services Rules contains the conduct of business rules applicable to Licence Holders. This section of the rules contains requirements dealing with **client classification**, client profile, disclosure to clients, **best execution**, client order handling, transactions executed with eligible counterparties, record keeping, **safeguarding of clients assets**, **conflicts of interest**, staff dealing, the provision of services through the medium of another Licence Holder, conduct of business rules for Licence Holders producing and disseminating investment research, conditions applicable to the provision of information, **complaints handling**, provisions applicable to Licence Holders whose staff promote and sell investment products; provisions applicable to Licence Holders appointing tied agents and provisions applicable to Licence Holders appointing introducers.

Guidance Note No 2 deals with the standard licence conditions on client classification, client profile requirements, best execution, inducements, safeguarding of clients assets, conflicts of interest policy, and complaints handling.

#### 2 [A] Client Classification

##### 2 [A.1] Client Classification Policies & Procedures– [SLCs 2.03 – 2.12]

- [i] SLC 2.03 requires Licence Holders to classify their clients or potential clients before providing an investment service. There are three tiers of client categorisation under MiFID, these being: **(a)** retail clients; **(b)** professional clients and **(c)** eligible counterparty.
- [ii] In terms of SLC 2.04, Licence Holders are required to implement appropriate written internal policies and procedures to categorise clients. The purpose of this Guidance Note is to assist Licence Holders in this regard by indicating what such policy could possibly include.
- [iii] Licence Holders are to have proper organisational requirements enabling them to classify clients in a quick and easy manner. This notwithstanding, it

should be ensured that the classification given by the Licence Holder is appropriate and any investment services offered to the client are to be undertaken on the basis of that classification.

**[iv]** It is recommended that a Licence Holder's client classification policy caters for the procedure which the Licence Holder's employees must adopt in order to classify clients under one of the following sub-headings (a), (b) or (c) below. Such procedures could be structured as follows:

**(a) First Tier Classification: - Eligible Counterparties**

Does the client or potential clients have any **one** of the following statuses?

- i.** An investment firm
- ii.** A credit institution
- iii.** An insurance company;
- iv.** A UCITS or a UCITS management company;
- v.** A pension fund or a pension fund management company;
- vi.** Another financial institution authorized or regulated under EU Law or the national law of an EU Member State;
- vii.** Undertakings which are exempt from the requirements of the MIFID in terms of Article 2 (1) (k) and (l) thereof;
- viii.** A national government and its corresponding offices including public bodies that deal with public debt;
- ix.** Central bank and supranational organization.

If so, the client may be classified as an 'eligible counterparty'.

**(b) Second Tier Classification: - Professional Clients**

Professional Client Test – No 1:

Does the **client** or **potential client** fall in any one of the following categories?

- [1]** An entity which is required to be authorised or regulated to

operate in financial markets. The list below should be understood as including: **[i]** all authorised entities carrying out the characteristic activities of the entities mentioned; **[ii]** entities authorised by a Member State under a Directive, **[iii]** entities authorised or regulated by a Member State without reference to a Directive, and **[iv]** entities authorised or regulated by a non-Member State:

- a. Credit Institutions;
- b. Investment Firms;
- c. Other authorised or regulated financial institutions;
- d. Insurance Companies;
- e. Collective investment schemes and management companies of such schemes;
- f. Pension funds and management companies of such funds;
- g. Commodity and commodity derivatives dealers;
- h. Locals;
- i. Other institutional investors.

**[2]** Is the client an entity which meets two of the following requirements?

- a. Balance sheet total:   EUR       20,000,000
- b. Net turnover:           EUR       40,000,000
- c. Own funds:             EUR       2,000,000

**[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.

If the client falls under anyone of [1] – [4] above, it may be classified as a ‘Professional Client’.

### Professional Client Test – No 2:

A client who does not fall under any of the above categories may also be treated as a professional client upon request if further to an assessment, such client is found to possess sufficient **experience**, **knowledge** and **expertise** to enable him/her to make his/her own investment decisions and properly assess the risks that such investment incurs.

In the course of this assessment, two of the following criteria should be satisfied:

- a. the client invests at an average frequency of ten transactions per quarter during the previous four quarters, subject to the transactions being of a significant size;
- b. the client’s financial instrument portfolio exceeds EUR 500,000;
- c. the client has worked in the financial sector for at least one year in a professional position.

In addition to satisfying two of the above-mentioned criteria, clients which have requested to be treated as professional clients must:

- a. state in writing that they wish to be treated as a professional client, either generally or in respect of a particular investment service or transaction or type of transaction or product;
- b. be given a clear written warning of the protections and investor compensation rights they may lose; and
- c. state in writing in a separate document from the contract, that they are aware of the consequences of losing such protections.

### (c) **Third Tier Classification:- Retail Clients:**

Clients who are not categorised as eligible counterparties or

professional clients must be classified as retail clients.

2 [A.2] *Relying on previous client classification or on another group company's client classification*

- [i] In terms of SLC 2.12, if clients have already (i.e. prior entry in to force of the current rules or client classification) been categorised as professionals under **parameters and procedures similar to those indicated above**, it is not intended that the Licence Holder should be affected by the above.

As explained in point 2.8 [f] of the MFSA feedback statement on MiFID dated 28<sup>th</sup> January 2007, for the purposes of SLC 2.12, investors who are currently classified as “Non-Private Clients” in terms of the current Investment Services Guidelines would be considered as professional clients for the purposes of MiFID on the basis that the current criteria for the determination of whether clients may be considered to be “Non-Private”, are similar to those established by MiFID. Although the requirements of SLC 2.04 will be implemented on 1st November 2007, it is recommended that ISLHs advise clients who are currently classified as “Non-Private” that it is their (i.e. the clients’) responsibility to keep the ISLH informed about any changes which could affect their current categorisation. Moreover, it is up to the ISLH to take the appropriate action should it become aware that a particular client no longer fulfils the initial conditions which made him eligible for professional treatment.

- [ii] Moreover, subject to any applicable data-protection requirements, the MFSA has no-objection to the sharing by a Group of Companies of the data obtained during a client classification exercise.

## **2 [B] Client Profile Requirements – [SLCs 2.13- 2.26]**

### *Introduction:*

SLC 2.13- 2.26 relate to a Licence Holder's obligation of undertaking a suitability or appropriateness test for each of its clients depending on the services offered by such Licence Holder to the respective client. These guidelines have the purpose of assisting Licence Holders with the implementation of the requirements set in the SLCs.

For the better understanding of the relevant Standard Conditions, these Guidance Notes have been divided into 3 sections: **(a)** assessment of suitability; **(b)** assessment of appropriateness; and **(c)** further consideration.

### **2 [B.1] *Assessment of Suitability***

Licence Holders are reminded that a transaction may be unsuitable for the client or potential client because of the risks of the financial instruments involved, the type of transaction, the characteristics of the order or the frequency of the trading. A series of transactions that are each suitable when viewed in isolation may be unsuitable if the recommendation or the decisions to trade are made with a frequency that is not in the best interests of the client. In the case of portfolio management, a transaction might also be unsuitable if it would result in an unsuitable portfolio.

- [i]** A firm is required to assess the suitability of an investment service or product to be offered to a client only when it is providing that particular client the investment service of **investment advice** or **portfolio management** [SLC 2.13].
  
- [ii]** In assessing such suitability, a Licence Holder should seek to establish the client's or potential client's:
  - (a) knowledge and experience:** in the investment field relevant to the specific type of product or service being offered to him/her by the Licence Holder including: **[i]** the type of service, transaction and financial instrument with which the client is familiar; **[ii]** the nature, volume, frequency of the client's transactions in financial instruments and the period over which they have been carried out; and **[iii]** the level of education, profession or relevant former profession of the client or potential client [SLC 2.16 & 2.22];
  
  - (b) financial situation:** established through obtaining information (amongst others) about the client's **[i]** regular income; **[ii]** assets-



including liquid assets investments and real property; **[iii]** regular financial commitments **[SLC 2.16 & 2.18]**;

- (c) **investment objectives:** established through obtaining information (amongst others) about **[i]** the length of time for which the client wished to hold the investment; **[ii]** the client's preferences regarding risk taking; **[iii]** the client's risk profile; and **[iv]** the purpose of investment **[SLC 2.16 & 2.19]**.

**It should be noted that Licence Holders who do not obtain this information should not proceed with the provision of investment advice or portfolio management to/ for the client.**

**[iii]** In obtaining the information detailed in **[ii]** above from a client, the Licence Holder should aim to determine whether the service provided and transaction to be recommended:

- (a) meets the investment objectives of the client in question [not applicable for professional clients];
- (b) is such that the client is able to financially bear any related risk;
- (c) is such that the client has the necessary experience and knowledge to understand the risks involved in the transaction or in the management of his/her portfolio [not applicable for professional clients].

**[iv]** For further guidance as to how the required information for performing a suitability test may be collected, kindly refer to **Appendix IV** which includes a specimen client fact find.

**2 [B.2]**     Assessment of Appropriateness

- [i]**           Assessing the appropriateness of an investment service or product to be offered to the client enables the Licence Holder to determine whether the client has the necessary experience and knowledge to understand the risks involved in the product or service offered or demanded [SLC 2.14].

Following the assessment of appropriateness, a Licence Holder should warn the client (which warning may be provided in standardised format) if the Licence Holder is of the opinion that the requested product or service is inappropriate for the client.

- [ii]**           In assessing the appropriateness of whether the investment service or product envisaged is appropriate for the client, the Licence Holder should try to establish:

- (a)**    the type of service, transaction and financial instrument with which the client is familiar;
- (b)**    the nature, volume, frequency of the client's transactions in financial instruments and the period over which they have been carried out;
- (c)**    the level of education, profession or relevant former profession of the client or potential client.

- [iii]**           A Licence Holder is required to assess the appropriateness of an investment service or product for a client when it provides an investment service to such client which investment service does not involve the provision of investment advice or portfolio management, and where the conditions set out below in [iv] are not satisfied in full.

- [iv]**           A Licence Holder is not required to assess the appropriateness of an investment service or product for a client if the following conditions are satisfied:

- (a)**    the service is being provided in relation to non-complex instruments as defined in SLC 2.25 (a) and 2.26 of the Rules;
- (b)**    the service is provided at the initiative of the client or potential client i.e. execution only services; and
- (c)**    the client or potential client has been clearly informed that in the provision of the service, the Licence Holder is not required to assess the suitability of the instrument or service provided or offered and that therefore, he/ she does not benefit from the corresponding protection

of the relevant conduct of business rules. The warning may be provided in standardised format.

(d) the Licence Holder complies with its obligations in relation to the management of conflicts of interest as set out in SLC 2.94 to 2.100.

[v] In cases where the client itself decides not to provide the information required by the Licence Holder to effectively carry out its assessment of appropriateness, the Licence Holder must warn the client in question (which warning may be provided in standardised format) that his election not to provide the required information will not allow the Licence Holder to appropriately determine whether the service or product offered is indeed appropriate for him.

For further guidance as to how the required information for performing an appropriate test may be collected, kindly refer to **Appendix V** which includes a specimen client fact find.

**2 [B.2a]** Provision of Services ‘At the Initiative of the Client’

[i] Standard Licence Condition 2.25 stipulates a number of conditions which need to be satisfied for the exemption from the requirement to perform an ‘appropriateness test’ to apply. In terms of SLC 2.25(b), the service is to be provided **at the initiative of the client or potential client**. Whilst the Standard Licence Conditions do not provide a definition of this concept, **Recital 30** of the Markets in Financial Instruments Directive (‘MIFID’) provides two tests as to when a transaction may be considered to be at the initiative of the client. Accordingly, at least one of these tests needs to be satisfied for the Licence Holder to consider a client to be requesting a service on his/her own initiative.

**The two Tests:**

[ii] **Test A:** A service may **be considered to be provided at the initiative** of the client if it is demanded by the client on the basis of any communication containing a promotion or offer of financial instruments made by any means that **by its very nature** is general and addressed to the public or larger group or category of clients or potential clients.

**Thus, this test depends on an evaluation of the MEDIUM of communication**

[iii] What is a means of communication that by **ITS VERY NATURE** is general and addressed to the public or larger group or category of clients or potential

clients?

The test, here, is whether the medium of communication allows a wide audience. The following are examples of such means of communications which allow a wide audience:

- (a) Billboards
- (b) Newspaper Adverts
- (c) General Website (i.e. websites not requiring a password for access)

The following means of communications are excluded: letters, emails, text messages and telephone calls. These means of communications should only be subject to **Test B** below since **OF THEIR VERY NATURE**, they are not that general and addressed to the public or larger group or category of clients or potential clients

**[iv]** **Test B:** A service is **NOT** provided at the initiative of the client (and therefore an appropriateness test is required) if the client demands it in response to a communication **WHICH IS** a personalized communication **AND WHICH** contains an invitation or is intended to influence the client in respect of a specific financial instrument or specific transaction.

**NB:** This test has two limbs which must **BOTH** be satisfied for a transaction **NOT** to be considered to be requested at the initiative of the client.

Thus, in order to consider a service to be provided “at the initiative of the client”, the Licence Holder must show **EITHER** that:

- (a) the communication was **NOT** personalized **OR THAT**
- (b) such communication neither did contain an invitation, nor was it intended to influence the client in respect of a specific financial Instrument.

**[v]** What is a “*personalized*” communication?

The key determinant as to what constitutes a “personalized recommendation” should be the *likely perception of the client upon receiving the communication* rather than the process that the firm has followed in deciding to make the communication to the client. This means that:

- (a) The evaluation should depend on the **CONTENT** of the communication. (a mass communication could still give the impression

that it is a personalized communication).

- (b) The fact alone that the communication has been addressed to the recipient for the purposes of transmission does not make it a personalized communication
- (c) If the **CONTENT** of the communication **GIVES THE IMPRESSION THAT IT IS NOT PERSONALIZED**, it should not matter that the firm has only sent it to a particular group of clients (rather than to all its clients base).

**[vi]** The following guiding questions may be considered in this context:

- (a) Does the communication refer to the client’s personal circumstances (e.g. the investment is indicated as suitable for the client to whom it is being addressed given his/ her capital growth objective)? This would personalize the communication.
- (b) Does the communication include details of the client’s existing holdings? This would personalize the communication.
- (c) Does the communication refer to characteristics of a target market/client base in general (e.g, a letter with the heading “are you approaching the age of retirement”?) This is less likely to make the communication personalized.
- (d) Is the content of the communication changed for each potential client? If so, this is likely to make the communication personalized.
- (e) If it is a personalized communication, does it contain an invitation or is it intended to influence a client with reference to a specific financial instrument or transaction? If the communication is personalized but does not contain an invitation or is not intended to try and influence a client about a specific transaction or instrument, any subsequent requests from the client could still be deemed to be ‘at the initiative of the client’

**[vii]** When does a communication deemed to contain an “invitation” or to be intended to “influence the client with reference to a specific financial instrument or transaction”?

An invitation may be defined as a “*spoken or written request for someone’s presence or participation*”.

- (a) Application Forms

An application form for the purchase of an instrument may be considered by the person receiving it as an invitation to actually purchase such instrument.

**(b) Buy/Sell Recommendations.**

The inclusion of buy/sell recommendations with mailshots / emails, irrespective of whether such recommendations are of a general nature or not should be considered as intended to influence the client with respect to a particular instrument or transaction.

**[viii] Conclusions.**

- (a)** Mailshots, emails, text messages and telephone calls should only be subject to Test B since they fall out of the scope of Test A.
- (b)** The nature of a communication could be affected by how its contents are phrased.
- (c)** “Generic” marketing material (e.g. a flyer) may still be deemed to be part of a personalized communication if accompanied by a covering letter which clearly refers to the recipient’s circumstances.
- (d)** The filtering of a mailing list (such that a communication is only sent to a portion of the Licence Holder’s clients), does not automatically make the communication personalized if this is not apparent to the recipient from the content of the communication.
- (e)** The inclusion of an application form and/or a general buy/sell recommendation with a mailshot or a flyer may be considered as an invitation to the client to carry out a particular transaction with respect to a particular instrument. Moreover, the sending of such an application form with a mailshot may also be considered as influencing the client’s decision with respect to a particular transaction. However, whether a transaction on the basis of such communication would be considered to be at the initiative of the client would depend on whether it is obvious from the content of the mailshot that this has been personalized.
- (f)** A client’s use of an e-brokerage facility to conclude a transaction would normally fulfil the condition that there should be no personal communication.
- (g)** Where there is a clear personal contact between the client and a representative of the Licence Holder, it would be difficult to argue that

the service is provided at the initiative of the client, especially when there is a previous approach (albeit for other products) by the representative. However, this does not mean that in every case the representative will be providing a non-execution only service. There may well be cases where there is a continuous Licence Holder-client relationship, but the service would still be at the initiative of the client. If the representative can prove that although the client was personally approached for another product, the client finally bought another product without any intervention on the part of the representative, the service could be considered as provided ‘at the initiative of the client’

- (h) The matrix below aims to apply the above two tests to certain practices resorted to by Licence Holders when communicating with clients, with a view to providing guidance as to when such communications result in the provision of services“ at the initiative of the client.”

[ix] **It is important to note that in referring to this matrix and seeking to apply it in practice, Licence Holders should take into account the particular circumstances of the scenario they are faced with in light of contents of this Guidance Note. The matrix should only serve as a rough guide and does not remove the need for Licence Holders to exercise their own judgment.**

# MFSA

## MALTA FINANCIAL SERVICES AUTHORITY

<b>Subsequent service/transaction at Initiative of the Client</b>  <b>SLC 2.56 (b)</b>	LH sends envelope/ email addressed to client including covering letter <b>drawing recipients' attention to enclosures/attachments</b> which are a product leaflet and relevant application form and a general buy/sell recommendation.	LH sends envelope/email to client containing/attaching a product leaflet and/or relevant application form and/or general recommendation <b>(without covering letter)</b>	LH sends a text message to a small number of selected clients, referring to their existing investments and inviting them to consider products or instruments offered by the LH.	LH sends mailshot to all or some of its existing clients, referring to their particular circumstances, e.g. "Dear Mr. Borg, as you are reaching retirement, we have products which may suit your needs..."	LH distributes a communication advertising a particular product or its services. (e.g. flyer in newspaper or magazine)	LH issues advertorial in the newspaper advertising its services and referring to a general buy/sell recommendation with respect to a particular product/instrument	LH simply forwards on primary issues application forms to clients
<b>TEST A:</b>							
Is means of communication <b>OF ITS VERY NATURE</b> general (and hence excludes a personal communication)?	NO	NO	NO	NO	Yes	Yes	No
<b>TEST B:</b>							
Personalised Communication	No*	No	Yes	Yes	No	No	No
Contains an Invitation or is Intended to influence the Client	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<b>Analysis</b>	Transaction at initiative of client	Transaction at initiative of client	Transaction <b>NOT</b> at initiative of client	Transaction <b>NOT</b> at Initiative of client	Transaction at Initiative of client	Transaction at Initiative of client	Transaction at Initiative of client

\* Provided the covering letter includes a **prominent disclaimer** to the effect that it is a standard letter which has been sent to various clients/potential clients and that it should not be construed by the recipient as a personal communication since it has not been tailored to suit the particular circumstances of the recipient.



## 2 [B.3] Further Considerations

**[i]** A Licence Holder should not encourage a client or potential client not to provide the necessary information for the proper compilation of the suitability or the appropriateness test.

**[ii]** A Licence Holder is entitled to rely on the information provided by the client or potential client unless it is aware that the information provided by the client or potential client is out of date, inaccurate or incomplete.

**[iii]** Reliance on Others:

In terms of the reliance-on-others provisions set out in SLC 2.106 – 2.108, a Licence Holder which receives an instruction to perform investment or ancillary services on behalf of a client through the medium of another investment firm may rely on the information provided by the said investment firm and the suitability and appropriateness determination prepared by that third party.

Conditions which apply for the reliance on others provisions to apply:

- (a)** the third party must provide the Licence Holder with an instruction to perform investment or ancillary services;
- (b)** the third party must be an investment firm;
- (c)** the third party who provides the instructions must be some-body other than the Licence Holder's client.

## **2[C] Best Execution Requirements– [SLCs 2.54 – 2.71]**

SLCs 2.54 to 2.62 and 2.70 to 2.71 lay down the requirements which Licence Holders executing orders on behalf of clients must satisfy in order to ensure the best execution of their client orders. Furthermore, SLC 2.63 to 2.69 set special provisions applicable to Licence Holders which provide the service of reception and transmission of orders and/or portfolio management.

The duty of best execution of client orders is owed by Licence Holders which:

- (a) execute orders on behalf of clients and /or
- (b) provide the service of reception and transmission of orders when transmitting such orders to other entities for execution and /or
- (c) provide the service of portfolio management, when placing orders with other entities for execution that result from decisions to deal in instruments on behalf of clients' portfolios.

**Guidance Note 2 [C] has the aim of providing Investment Services Licence Holders with further guidance as to how they can comply with their best execution obligations.**

### **Definitions**

Words and expressions which are also used in the Investment Services Rules shall have the same meaning as defined in the Glossary thereto. In addition, for the purposes of this Guidance Note, the following terms shall have the meaning set out below:

**“best execution factors”**: the factors listed in SLC 2.54 and referred to in SLC 2.66

**“carrying out”**:

- (i) executing an order on behalf of a client;
- (ii) when providing the service of portfolio management, placing an order with an entity for execution that results from a decision to deal in instruments on behalf of a portfolio or executing a decision to deal in instruments on behalf of a client;
- (iii) when providing the service of reception and transmission of client orders, transmitting client orders to other entities for execution.

**“overarching best execution requirements”:** The requirement under SLC 2.54 and referred to in SLC 2.66 to take all reasonable steps to obtain the best possible result for the execution of client orders, taking into account the best execution factors.

**“entities”:** Natural or legal persons or other entities that either transmit or execute orders in financial instruments.

**“execute orders or decisions to deal”:** Execute orders on behalf of clients, or execute decisions to deal on behalf of client portfolios when providing the service of portfolio management.

**“execution venues”:** Regulated Markets, Multilateral Trading Facilities (“MTFs”), systematic internalisers or other liquidity providers or entities that perform a similar function in third countries to the function performed by any of the foregoing.

**“total consideration”:** The price of a financial instrument and the costs related to execution, including all expenses incurred by the client which are directly related to the execution of the order such as execution venue fees, clearing and settlement fees, and any other fees paid to third parties involved in the execution of the order.

**“transmit or place orders with other entities for execution”:** to transmit client orders to other entities for execution when providing the service or reception and transmission of orders, or place orders with other entities for execution that result from decisions to deal in financial instruments on behalf of client portfolios when providing the service of portfolio management.

**2 [C.1] What is the Overarching Best Execution Requirement?**

- [i]** In terms of SLCs 2.54 *et seq.* of the Investment Services Rules, there is an overarching requirement on Licence Holders to take all reasonable steps to obtain the best possible result for the execution of client orders for retail and professional clients, taking into account, certain factors such a price, costs, speed, the likelihood of execution and settlement, size and nature of the transaction.
  
- [ii]** The obligation to deliver the best possible result when executing client orders applies in relation to all types of financial instruments. However, given the differences in market structures or the structure of financial instruments, it may be difficult to identify and apply a uniform standard of any procedure for best execution that would be valid and effective for all classes of instruments. In this regard, although the overarching best execution requirement sets a high level standard, it allows Licence Holders a considerable degree of flexibility on how to meet it. Nevertheless, the Investment Services Rules require Licence Holders to comply with a number of specific provisions.
  
- [iii]** In terms of SLC 2.55, Licence Holders that execute orders or decisions to deal should establish “execution arrangements” and an “execution policy” for complying with the overarching best execution requirement. Similarly, firms that transmit or place orders with other entities for execution should establish a “policy” for complying with the overarching best execution requirement. Licence Holders should carry out orders on behalf of clients in accordance with their execution policies and/or arrangements.
  
- [iv]** In order to comply with the over arching best execution requirement, Licence Holders are recommended to ensure that appropriate execution policies and/or arrangements are effectively implemented for the carrying out of all orders. Licence Holders, however, are not under an obligation to obtain the best possible result for each individual order: rather they are advised to apply their execution polices to each order with a view to obtaining the best possible result in accordance with the execution policy.
  
- [v]** SLC2.56 requires Licence Holders that carry out orders to disclose “appropriate information” to clients about their execution policies. Furthermore, in terms of SLC 2.57, Licence Holders are required to monitor and review the performance of their execution policies.

**2 [C.2]** *To whom does the Obligation to Provide Best Execution Apply?*

**[i]** The obligation of best execution is owed by Licence Holders which ***act on behalf of a client*** and which therefore either:

- (a)** themselves execute orders or decisions to deal on behalf of clients; or
- (b)** transmit or place orders with other entities for execution on behalf of clients.

Licence Holders providing portfolio management services are also bound by the best execution obligations contained in the SLCs since, in the course of providing such services they would inevitably perform one of the activities indicated in (a) or (b) above in the course of managing their clients' portfolios.

**[ii]** Licence Holders' duty of best execution of client orders arises whenever Licence Holders act on behalf of their retail or professional clients. In terms of SLC 2.82, Licence Holders do not owe a duty to provide best execution with respect to clients which qualify to be treated as eligible counterparties.

**[iii]** The application or otherwise of the best execution requirements will depend on whether the execution of the client's order by the Licence Holder can be seen as being truly done ***on behalf of the client***. This is a question of fact in each case which ultimately depends on whether the client legitimately relies on the Licence Holder to protect his or her interests in relation to the pricing and other elements of the transaction that may be affected by the choices made by the Licence Holder when executing the order. The following considerations, taken together, will help to determine this issue:

- (a)** Whether the Licence Holder approaches (initiates the transaction with) the client or whether it is the client who approaches the Licence Holder first. In the former case it is more probable that the client (especially when it is a retail client) will be relying on the firm to protect his or her interests in relation to the pricing and other details of the transaction.
- (b)** Questions of market practice will help to determine whether it is legitimate for clients to rely on the firm. For example in the wholesale bond markets buyers conventionally 'shop around' by approaching several dealers for a quote, and in these circumstances there is no expectation between the parties that the dealer chosen by the client will owe best execution.

- (c) The transparency of a market will also be relevant. For markets where clients do not have ready access to prices, the conclusion will be much more readily reached that they rely on the Licence Holder in relation to the pricing of the transaction.
        - (d) The information provided by the Licence Holder about its services and the terms of an agreement between the client and the Licence Holder will also be relevant, but not determinative of the question. The use of standard term agreements to characterise commercial relationships otherwise than in accordance with economic reality should be avoided.
- [iv] The factors mentioned in [iii] above are likely to support the presumption that, in ordinary circumstances, a retail client legitimately relies on the Licence Holder to protect his or her interests in relation to the pricing and other parameters of the transaction.
- [v] Transactions based on a client's request to the Licence Holder to buy or sell a financial instrument for him/ her fall within the concept of execution of an order on behalf of a client. Such transactions include:
  - (a) Executing a client order by dealing as agent for a client. In this situation, the intermediary takes a customer order and places the order, on behalf of the client, with an execution venue (such as an exchange, a systematic internaliser or another liquidity provider) for execution.
  - (b) Executing a client order against the Licence Holder's own proprietary position (including as a systematic internaliser), where the Licence Holder is making decisions as to how the order is executed: e.g. where it is "working the order" on the clients' behalf.
  - (c) Executing a client order by dealing as a riskless principal on behalf of the client, including cases where the client is charged a spread on the transaction. In this type of transaction, the Licence Holder will typically deal as principal with its client at the same time, and on the same terms (as to instrument, time and price (allowing for any spread)), as it enters a transaction as a principal with a counterparty.
- [vi] Licence Holders which execute client orders on behalf of clients are required to:
  - (a) put in place arrangements including an execution policy so as to take all reasonable steps to obtain the best possible result for the execution of their client orders (SLC 2.55);

- (b) obtain client consent to the execution policy (SLC 2.56); and
  - (c) be able to demonstrate on a client's request that they have executed the client's order in compliance with their execution policy (SLC 2.58).
- [vii]** In terms of SLC 2.67, Licence Holders which receive and transmit orders for execution on behalf of clients or which place orders with entities for execution in the course of managing client portfolios must implement a "policy" to achieve the best possible result for client orders.
- [viii]** Licence Holders which operate by providing 'quotes' (i.e. prices at which they may be willing to buy or sell) whether continuously (for example through bulletin boards) or to particular persons who request the Licence Holder to provide a quote for a particular instrument, and then dealing with the person to whom they made a quote, are still considered to deal on their own account and hence subject to the best execution requirements.

**2[C. 3]** *What is the difference between Best Execution Arrangements and a Best Execution Policy?*

- [i]** SLC 2.55 requires Licence Holders to establish and implement effective arrangements in order to ensure the best possible result for clients when executing their orders. In this regard, Licence Holders are required to establish and implement an order execution policy.
  
- [ii]** The “execution arrangements” are the means that a Licence Holder employs to obtain the best result when executing orders or decisions to deal, while the “execution policy” may be understood as a document that describes the most important and/or relevant elements of those execution arrangements.



**2[C.4]** *What are the factors which determine Best Execution?*

**[i]** In terms of SLC 2.54, Licence Holders should consider the following factors when executing client orders in order to ensure the best possible result for their clients:

- (a)** price
- (b)** cost
- (c)** speed and likelihood of execution and settlement
- (d)** size
- (e)** nature
- (f)** any other consideration relevant to the execution of an order

The weight given to each of these factors would ordinarily depend on the type of the instrument to which a transaction relates. In this regard, SLC 2.59 sets out four criteria for determining the relative importance of the factors mentioned above.

It is the responsibility of the Licence Holder to assess the relative importance of the above mentioned factors, taking into account, criteria mentioned in SLC 2.59, which include, inter alia the characteristics of the client, including the categorisation of the client as retail or professional.

**2 [C.5]** *What are the Best Execution Obligations of the Licence Holder With Respect to Retail Clients?*

- [i]** Where a Licence Holder executes an order on behalf of a retail client, the best possible result shall be determined in terms of the “**total consideration**” (SLC 2.61). Total Consideration may be defined as the price of the instrument and the costs related to execution, including all expenses incurred by the client which are directly related to the execution of the order such as execution venue fees, clearing and settlement fees, and any other fees paid to third parties involved in the execution of the order.
- [ii]** For the purposes of determining the “**total consideration**” to be taken into account, the costs related to execution should include the Licence Holder’s own commissions or fees charged to the clients for limited purposes in cases where more than one venue listed in the Licence Holder’s execution policy is capable of executing a client order. In such cases, the Licence Holder’s own commissions and costs for executing the order on each of the eligible execution venues should be taken into account in order to assess and compare the results for the client that would be achieved by executing the order on each such venue. It is not intended to require a Licence Holder to compare the results that would be achieved for its client on the basis of its own execution policy and its own commissions and fees, with results that might be achieved for the same client by any other Licence Holder on the basis of a different execution policy or a different structure of commissions or fees. Nor is it intended to require a Licence Holder to compare the differences in its own commissions which are attributable to differences in the nature of the services that the Licence Holder provides to clients.

By way of example, a Licence Holder which provides a service to retail clients with respect to shares admitted to trading on a regulated market will focus on the net cost (or net proceeds in the case of a sale) of executing the order on the venues available, and will direct the order to the execution venue or entity providing the best possible result in terms of total consideration. The Licence Holder may consider speed, likelihood of execution and settlement, the size and nature of the order, market impact and any other implicit transaction costs and give them precedence over the immediate price and cost facts if they are instrumental in delivering the best possible result in terms of the total consideration to the retail client. Such implicit costs may be relevant for retail clients with respect to a large order in a relatively illiquid share, for example.

**2 [C.6]** *In formulating a Best Execution Policy, how should Licence Holders treat the fees and commissions they charge for providing investment services?*

**[i]** SLCs 3.22 and 2.44 contain specific disclosure requirements for retail clients regarding a Licence Holder's fees and commissions to ensure that these investors are able to compare the fee structure of different Licence Holders.

**[ii]** Licence Holders are free to set their fees and commissions at the level they choose, provided that no venue is unfairly discriminated against. In this regard, a Licence Holder should not charge a different commission (or spread) for execution on different venues unless the difference reflects a difference in the cost to the firm. For example, a Licence Holder may not direct all its orders to another Licence Holder within its corporate group on the basis that it charges its clients a higher fee for access to other venues that is unwarranted by higher costs.

**[iii]** When selecting venues to be included in its execution policy, a Licence Holder should not take into account the fees and commissions it will charge its clients. At this stage, the Licence Holder should focus on the potential of the venues to enable the Licence Holder to obtain on a consistent basis the best possible result for the execution of its client orders. In other words, it should focus on the quality of execution available on various venues.

**[iv]** When choosing a venue for the execution of a particular client order (from among the venues included in the Licence Holder's execution policy that are capable of executing such an order), the Licence Holder needs to take into account the effect of its own fees and commissions on the total consideration to the client.

By way of example, if a Licence Holder has included a regulated market and a systematic internaliser in its execution policy (or itself as a systematic internaliser) because both those venues enable the Licence Holder to obtain on a consistent basis the best possible result for the execution of its client orders, the Licence Holder will need to take into account not only the prices displayed by those two venues, but also any difference in fees or commission it charges the client for execution on one venue rather than the other (as well as any other costs or other relevant factors).

**2[C.7]** *What are the Best Execution Obligations of the Licence Holder With Respect to Professional Clients?*

**[i]** Although SLC 2.61 limits the concept of total consideration for execution of orders from retail clients, the concept is also relevant for the assessment of best execution for orders coming from professional clients since in practice it would be difficult to disregard the importance of the net cost of a purchase or the net proceeds of a sale in any evaluation of best execution.

With respect to professional clients, however certain factors may be more important in determining best execution for orders coming from such clients. The SLCs clearly allow Licence Holders flexibility in this regard.

**2 [C.8]** *What are the Effects of Specific Instructions given to the Licence Holder by the Client?*

- [i]** According to SLC 2.60, when a Licence Holder executes an order following specific instructions from a client, it will be deemed to have satisfied its obligations under SLC 2.54 to take all reasonable steps to obtain the best possible result for that client. However, the fact that the client has given specific instructions which cover one part or aspect of the order should not be treated as releasing the Licence Holder from its best execution obligations in respect of any parts or aspects of the client order which are not covered by such instructions.
- [ii]** A Licence Holder should not induce a client to instruct it to execute an order in a particular way, by expressly indicating or implicitly suggesting the content of the instruction to the client, when the Licence Holder ought reasonably to know that an instruction to that effect is likely to prevent it from obtaining the best possible result for that client. In such cases the Licence Holder would be considered to be avoiding its best execution obligations.
- [iii]** A Licence Holder would still be able to invite a client to choose between two or more specified trading venues, provided that those venues are consistent with the execution policy of the Licence Holder.
- [iv]** Where a Licence Holder provides a quote to a client in a manner that would meet the Licence Holder's obligations under SLC 2.54 had the Licence Holder executed that quote at the time the quote was provided, the Licence Holder would be deemed to meet those same obligations if it executes its quote after the client accepts it – provided that taking into account the changing market conditions and the time elapsed between the offer and acceptance of the quote, the quote is not manifestly out of date.

Specific Instructions with Respect to customised products (e.g. Over The Counter products ('OTC') and other complex products.

- [v]** Where the client indicates his/her needs with respect to exposure and protection, the Licence Holder is not necessarily exonerated from its best execution obligations on the basis that it has received specific instructions from a client. In the first stage, where the Licence Holder proposes to the client the elements of an OTC derivatives contract which would meet the client's needs, it is more appropriate to speak of investment advice rather than best execution. Once the client accepts the particular tailored structure, the best execution obligations would start to apply. The practical content of such obligations with respect to a customised instrument would amount to the

Licence Holder offering the 'best' price which is fair given the hedging possibilities or modelling constraints.

- [vi] Ordinarily, in those circumstances where best execution applies, the identity of the instruments sought will be a matter of the information contained in the order rather than a question of specific instructions. Nevertheless, there may be a level of discretion as to exactly which instruments to obtain on behalf of a client in the order.
- [vii] In the case of complex instruments (that is products which are composed of or represent the performance of more than one product), the best execution requirements (when applicable) apply to the product as a whole. Best execution for the product as a whole may conceivably be obtained even if best execution for each component of the product, when considered in isolation, is not obtained.

**2 [C.9]**     What Should a Best Execution Policy Contain?

**[i]**           An execution policy should:

- (a)**       set out the Licence Holder’s strategy for obtaining the best possible result for the execution of its client orders, including the key steps the firm is taking to comply with the overarching best execution requirement and how those steps enable the firm to obtain the best possible result.
- (b)**       include an account of the relative importance, or the process for determining the relative importance, the Licence Holder places on the best execution factors when executing client orders or decisions to deal, as well as information on how those factors affect the Licence Holder’s choice of execution venues for inclusion in the best execution policy.
- (c)**       Set out the execution venues the Licence Holder uses. SLC 2.56 states that the execution policy “*shall at least include those venues that enable the Licence Holder to obtain on a consistent basis the best possible result for the execution of client orders.*” **This means that the Licence Holder may only use venues listed in its execution policy and not that the Licence Holder should list all the possible venues where it could execute orders in a particular instrument.** A Licence Holder may however, in exceptional circumstances, use venues not listed in its policy, for example on a provisional basis or to accommodate a client request to trade in an unusual instrument, with a view to satisfying the overarching best execution requirement.
- (d)**       Explain how different factors which influence the Licence Holder’s execution approach for carrying out client orders will deliver the best possible result for the execution of those client orders.

**[ii]**           The obligation, in terms of SLC 2.54, to take all reasonable steps to obtain the best possible result for the client, should not be treated as requiring a Licence Holder to include in its execution policy all available execution venues.

Possibility of a Single Execution Venue or Entity

**[iii]**           It is possible to include only a single execution venue in a Licence Holder’s execution policy in cases where such a single venue or entity will deliver the best possible result on a consistent basis for some instruments and orders. However, in arriving at such conclusion the Licence Holder should have

assessed all the possible alternatives to the inclusion of a single venue/entity, including the advantages of indirect access (i.e. transmitting the orders of its clients to another execution intermediary rather than executing those orders itself).

- [iv] In order to comply with the general requirement in SLC 2.01 to act in the best interest of its clients, a Licence Holder should consider transmitting client orders instead of executing them itself where that would deliver a better result for clients, provided the Licence Holder is licensed to receive and transmit orders on behalf of clients.

#### Differentiations in the policy according to instrument

- [v] In terms of SLC 2.56, the execution policy must include, in respect of each class of instruments, information on the different venues where the Licence Holder executes its client orders and the factors affecting the choice of execution venue. This means that the execution policy of a Licence Holder (irrespective of whether that Licence Holder executes the order itself or passes on that order for execution to another intermediary) should reflect any significant variations in its approach with respect to each class of instrument. It follows that appropriate information about these significant variations should be included as part of the information that must be disclosed by the Licence Holder to its clients.
- [vi] Appropriate differentiation will depend on the types of clients a Licence Holder serves, the instruments for which it handles orders and the relevant market structures and execution venues available for those instruments.
- [vii] In addition to differentiation by class of instrument, a Licence Holder may wish to distinguish its policy by client or order type.
- [viii] The differentiation in a Licence Holder's execution policy should be sufficient to enable the client to make a properly informed decision about whether to utilise the execution services offered by the Licence Holder. In order to do this, the execution policy will need to provide a sufficiently detailed description of the execution approach that the firm takes in order to obtain the best possible result for the relevant categories of instruments, orders, clients and markets it deals with.



**2[C.10]** *What are the Disclosure Requirements with Respect to the Licence Holder's Best Execution Policy?*

- [i]** The Licence Holder is required to inform its clients:
- (a)** in a durable medium or by means of a website ( SLC 2.71)(presentation);
  - (b)** in good time, prior to the provision of the service (SLC 2.71) (timeliness of disclosure); and
  - (c)** about the appropriate aspects of its execution policy (SLC 2.56) (content)

Content of Disclosure

- [ii]** The contents requirements in SLC 2.71 are intended to enable the client to act in an informed manner. By requiring ex ante disclosure of the execution policy, the Investment Services Rules address clients' information needs.
- [iii]** The information given to clients must be "appropriate and proportionate" and must take account of the status of a client as either retail or professional (see Recital 55 of the MiFID Implementing Directive). Accordingly, disclosure of the execution policy is only required insofar as it will be relevant for the client and types of orders which that client may send to the Licence Holder. Hence, a retail client will not require information on how the Licence Holder executes trades in instruments which are not typically purchased by retail clients.
- [iv]** A Licence Holder which receives and transmits orders for execution is required, in terms of SLC 2.67, to disclose, at least to retail clients, for each class of instruments, the entities with which orders are placed or to which orders are transmitted for execution.
- [v]** A Licence Holder which executes orders or decisions to deal should notify its clients of any material changes to its execution arrangements or execution policy in terms of SLC 2.57. A change is material where its disclosure is necessary to enable the client to make a properly informed decision about whether to continue utilising the services of the Licence Holder. In particular, a Licence Holder should consider the materiality of any changes it makes to the relative importance of the best execution factors or to the venues on which it places significant reliance in meting the overarching best execution

requirement.

- [vi] Although there is no comparable requirement for Licence Holders that only transmit or place orders with other entities for execution and which do not execute orders or decisions to deal, it is recommended that any material changes (such as the list of the entities to which orders are transmitted for execution) to such Licence Holders' policies should also be notified to clients.

### Presentation of the Disclosure

- [vii] The information regarding the Licence Holder's execution policy should be provided in a comprehensible form. This could be facilitated by concentrating all the relevant disclosures in a single document, for example.
- [viii] In terms of SLC 2.71 information must be provided either in a durable medium or by means of a website under certain conditions (please refer to SLCs 2.114 to 2.116). Other information that may be disclosed by the Licence Holder is not subject to these disclosure requirements. However, where a retail client agreement is required under SLC 2.39, such disclosure could be incorporated into the agreement.

### Disclosures for Professional Clients

- [ix] Professional clients should, subject to limited exceptions, be able to identify for themselves the information that is necessary for them to make an informed decision, and to ask the Licence Holder to provide that information. It is therefore up to the Licence Holder to determine what level of information disclosure is appropriate for professional clients, through appropriate consultation with such clients if necessary.

### Timeliness of Disclosure

- [x] The Licence Holder must disclose to its clients the details on its execution policy as indicated in SLC 2.71, in good time, prior to providing the service to that client.
- [xi] In determining what constitutes the provision of information relating to the execution policy of the Licence Holder in good time, the Licence Holder should take into account, having regard to the urgency of the situation and the time necessary for the client to absorb and react to the specific information provided, the client's need for sufficient time to read and understand it before

taking an investment decision (see Recital 48 of the MiFID Implementing Directive).

**2 [C.11]** *Is the Client's Express Consent to the Licence Holder's Best Execution Policy Necessary?*

- [i]** SLC 2.56 requires Licence Holders to obtain the prior consent of their clients to their execution policy. The *prior express consent* of clients is required before the Licence Holder proceeds to execute client orders, outside a regulated market or MTF. However, a Licence Holder does not have to obtain express consent from its clients where the relevant instruments are not admitted to trading on a regulated market or MTF.
- [ii]** Where mere consent (as opposed to prior express consent) is required, (in terms of SLC 5.56) this may be tacit and may result from the behaviour of the client (for example: if the client sends an order form after having read the Licence Holder's execution policy).
- [iii]** It is good practice for the Licence Holder to keep evidence of such tacit consent. MFSA may require access to any document or demand information in this regard. In particular the Licence Holder may be required to show that it has supplied its clients with the appropriate information, as required by the Investment Services Rules on its execution policy.
- [iv]** Where express consent is required, this must be actually expressed by the client. This may be provided by signature in writing or an equivalent means (electronic signature, by a click on a web page or orally by telephone or in person (with appropriate record keeping in each case).

**2 [C.12] How is the Licence Holder required to Review and Monitor its Execution Policy?**

**[i]** In terms of SLCs 2.57, 2.68 and 2.70, the Licence Holder is required to monitor and review its execution policy and its order execution arrangements, on a regular basis, to ensure that its execution approach is consistent with obtaining the best possible result for the execution of client orders.

Review

**[ii]** The requirement to review a Licence Holder's execution policy necessarily looks beyond the Licence Holder's current execution approach and must be carried out at least annually (SLC 2.70).

**[iii]** The Licence Holder should also review its approach generally to see whether it could usefully make any changes to improve overall performance. More specifically, the Licence Holder should consider whether the relative importance it has assigned to the factors in SLC 2.54 has led it to deliver the best possible result for its clients or whether it should reconsider this aspect of its execution approach.

**[iv]** SLC 2.70 also requires the Licence Holder to review its execution approach whenever a material change occurs which could affect its ability to obtain the best possible result for the execution of its clients' orders. What is material will depend to a large extent on the nature and scope of any change.

**[v]** Licence Holders which execute orders or decisions to deal will need to monitor and review the steps they are taking to deliver the best possible result, as well as the performance of the execution venues they are using.

**[vi]** If a Licence Holder carrying out portfolio management services is empowered to either execute its decisions to deal itself or to place orders with other entities for execution, then, as part of the review process, it should compare the performance of entities it uses with its own performance in executing its decisions to deal.

Monitoring

**[vii]** Monitoring is the assessment, on a regular basis, of particular transactions in order to determine whether the Licence Holder has complied with its execution policy and/or arrangements, and whether the resulting transaction has delivered the best possible result for the client.

- [viii]** There are two main areas which the Licence Holder may need to monitor to establish the effectiveness of its execution policy and arrangements:
- (a)** *Compliance with the execution approach:* The Licence Holder must ensure that it is actually following the execution approach it has established
  - (b)** *The quality of execution obtained through its execution policy:* The Licence Holder must assess whether it is actually obtaining the best possible result under its execution policy. This can be done by comparing similar transactions:
    - i.** On the same venue, in order to test whether a Licence Holder's judgement about how orders are executed is correct; or
    - ii.** On different venues chosen from among those in the Licence Holder's execution policy, in order to test whether the best venue is being chosen for a given type of transaction.
- [ix]** The method for monitoring is at the discretion of the Licence Holder. However, it is not necessary for these purposes that a Licence Holder reviews every transaction. Other approaches such as sampling could suffice. Sampling must however reflect the size and nature of the transactions performed and the Licence Holder must appropriately assess and compare the relevant available data.
- [x]** Licence Holders which execute client orders will need to review best execution policies in order to ascertain whether the venues they are using are delivering the best possible result for execution of their client orders, and decide whether to connect to execution venues excluded from the current execution policy. It is recommended that the execution quality being delivered by the venues currently included in the policy also be monitored.
- [xi]** Licence Holders dealing on own account with clients will need to review their own execution quality relative to other execution venues which they (or their clients) could potentially access.
- [xii]** Licence Holders should also monitor the impact of their own actions on the execution quality they achieve.
- [xiii]** Where monitoring reveals that a Licence Holder has fallen short of obtaining the best possible result, the Licence Holder should consider whether this is because it has failed to follow its execution policy and/or arrangements or

because of a deficiency in such policy and/or arrangements, and make appropriate amendments.

**2 [C.13]** *Can Licence Holders choose to Execute Deals only on Affiliated Execution Venues?*

- [i]** Licence Holders may achieve a more advantageous total consideration for their clients by directing all orders to an affiliated firm within their corporate group if that affiliated firm can provide the best possible result on a consistent basis and enable the Licence Holder to charge lower fees or commissions. In such cases, Licence Holders are still required to monitor and review the quality of execution provided (by the affiliated firm) and to take appropriate action to correct any deficiencies, in terms of SLC 2.57, in addition to having to fulfil the overarching requirement to take all reasonable steps to obtain the best possible result for clients.
  
- [ii]** Licence Holders will not be able to direct all its orders to an affiliated firm within its corporate group on the basis that it charges clients a much higher fee for access to other venues which fee is unwarranted by higher access costs.



**2[C.14] How does the Best Execution Obligation apply to Licence Holders Which Transmit or Place Orders With Other Entities For Execution to Other Intermediaries (Including Licence Holders Authorised to Provide Portfolio Management Services (SLCs 2.63 to 2.69))?**

- [i]** Licence Holders which receive and transmit orders to other intermediaries for execution typically operate by placing orders with or transmitting orders to other Licence Holders which execute the orders. In this way, a “chain of execution” may be seen to be formed with some aspects of execution being performed at different points in the chain.
- [ii]** A Licence Holder authorised to provide portfolio management which also executes orders on behalf of clients when it carries out transactions for its clients’ portfolio will be subject to the requirements of SLC 2.54 to 2.62 and 2.70 to 2.71.
- [iii]** A chain of execution can take many forms and may be of different length. The Investment Services Rules impose the best execution requirements on Licence Holders in different ways depending on the investment service the Licence Holder is providing. The overarching obligation however, is always that Licence Holders should take all reasonable steps to deliver the best possible result for their clients.
- [iv]** SLC 2.67 requires Licence Holders which receive and transmit orders to other intermediaries for execution to utilise entities whose execution arrangements enable the Licence Holders to comply with their own obligations under SLCs 2.63 to 2.69. Moreover, in terms of SLC 2.08, Licence Holders which receive and transmit orders for execution are obliged to monitor the execution quality of those entities on a regular basis. In this regard, such Licence Holders are recommended to examine the execution approaches of those entities prior to selecting them and keep these approaches under review as appropriate.

**Reliance by the Licence Holder on the Entities its selects to Execute Client Orders To Ensure Satisfaction of the Overarching Best Execution Requirement.**

- [v]** The SLCs relating to best execution are not intended to require a firm that transmits or places orders with other entities for executing to duplicate the efforts of its execution entities. Rather, a Licence Holder should determine that the entities it uses will enable it to comply with the overarching best execution requirement when placing an order with, or transmitting an order to, another entity for execution.

- [vi] A Licence Holder which receives and transmits orders for execution to another entity, which in its turn is subject to the requirements of Article 21 of the MiFID Directive may, provided certain conditions are met, be able to place a high degree of reliance on that intermediary in order to comply with its own best execution obligations under SLC 2.67. However, this does not relieve the Licence Holder from all best execution obligations, since these Licence Holders are not specifically exempted from the requirements of SLCs 2.63 to 2.69.
- [vii] To this end, a Licence Holder should review the execution arrangements of the entities it wishes to use to determine whether they will allow it to comply with all its best execution obligations.
- [viii] In determining whether an entity is likely to enable the Licence Holder to obtain the best possible result for its clients, a Licence Holder may also need to consider:
- (a) whether the entity itself is subject to the requirements of Article 21 of the MiFID Directive, that is, whether the entity is an investment firm executing or receiving and transmitting orders on behalf of the Licence Holder and the entity has agreed to treat the Licence Holder as a retail or professional client;
  - (b) whether the entity will undertake by contract to comply with any or all of the best execution requirements in relation to the relevant business with the result that it has contractual but not regulatory responsibilities for best execution; and
  - (c) whether the entity can demonstrate that it delivers a high level of execution quality for the kind of orders that the Licence Holder is likely to place with or transmit to it.
- [ix] With respect to the relevant business, if an entity is subject to Article 21 mentioned above or undertakes by contract to comply with Article 21, and then the Licence Holder merely transmits or places orders with the entity for execution, taking few steps itself that affect execution quality, and the Licence Holder has determined that the entity has arrangements that will enable the Licence Holder to comply with its obligations under SLCs 2.63 to 2.69 then that Licence Holder will be able to place a high degree of reliance on that entity in order to comply with its own overarching best execution requirement.
- [x] In the circumstances referred to in [ix] above, a Licence Holder would be complying with the overarching best execution requirement with respect to

particular orders simply by placing them with or transmitting them to such entities. Of course, the Licence Holder would still be subject to the other requirements of SLCs 2.63 to 2.69, in particular, the requirements to implement an appropriate policy and to monitor and review its effectiveness, including the execution quality actually delivered by such entities. The Licence Holder should not be able to continue to rely on an entity if its monitoring or review indicated that the entity was not, in fact, enabling the Licence Holder to obtain the best possible result for the execution of its client orders.

**[xi]** When devising its policy, the Licence Holder should consider whether it is reasonable to transmit or place orders with another entity for execution or whether it is necessary to exercise some additional control over how its orders are executed, in order to meet the overarching best execution requirement. Similarly, any action the Licence Holder takes that may affect the quality of execution of the order, should be consistent with the overarching best execution requirement.

**[xii]** A Licence Holder which receives and transmits orders to another intermediary for execution may sometimes wish to specify aspects of the execution service. For example, it may specify that a particular type of order must be executed on a venue that it chooses (for example a venue which the Licence Holder can only access through an intermediary). In such cases, where the requirements of Article 21 of the Directive apply to the executing intermediary in respect of the transaction, the intermediary could regard this as a specific instruction in which case the Licence Holder transmitting the order will not be able to rely on the intermediary for this aspect of the execution it obtains.

Licence Holders which receive and transmit orders with respect to the subscription and redemption of units in collective investment schemes.

**[xiii]** Licence Holders receiving and transmitting orders for the subscription of units in a collective investment scheme are still bound to comply with the best execution principle. In terms of SLC 2.67, such Licence Holders are required to:

- (a)** establish and implement a best execution policy which should identify, in respect of each class of instrument the entities with which the orders are placed or to which the Licence Holder transmits orders for execution;
- (b)** indicate in such policy the entities with which the orders are placed to which the Licence Holder transmits orders for execution. These would

be the Fund Manager(s) or Administrators of the relative collective investment schemes;

- (c) provide sufficient information about the execution policy to all its clients (irrespective of where such client are based) such that clients would be enabled to make a properly informed decision about whether to utilise the services offered by the Licence Holder.

### Review of Execution Policy

- [xiv] Although Licence Holders which receive and transmit orders for execution to another intermediary are required, by SLC 2.67, to establish and implement an execution policy and disclose appropriate information about that policy, they are not required, in terms of SLCs 2.63 to 2.69 to obtain client consent thereto or to demonstrate to clients that they have complied with its execution policy.
- [xv] Licence Holders which receive and transmit orders for execution to another intermediary will need to review their execution policy, in terms of SLC 2.68, in order to ascertain whether the results from firms they use achieve a better result than the results that are being delivered by other firms in the market. If a portfolio manager's policy includes other investment firms acting as intermediaries as well as direct access to markets and/or other investment firms dealing on own account, then these would need to be reviewed relative to one another as part of the review process. Such Licence Holders will also need to monitor the execution quality they obtain from other intermediaries and/or venues that are included in their policy to ensure they are delivering the best possible result under the current policy.
- [xvi] Licence Holders which receive and transmit orders for execution to another intermediary, are still required to review their policies annually and whenever a material change occurs (SLC 2.68).
- [xvii] Licence Holders that transmit or place orders with other entities for execution may need to take different approaches to their review and monitoring requirements, depending on how much control they exercise over the way their orders are executed. A Licence Holder may merely send orders received or decisions to deal to an entity for execution, taking few steps itself that affect execution quality and therefore relying to a high degree on the entity with respect to how orders are to be executed; alternatively, it may provide that entity with more or less extensive instructions about how the order should be executed or take steps to manage the execution of the order itself before sending the order to an entity. In the second case, the Licence Holder should monitor and review its own actions and their impact on the execution quality

it is obtaining.

- [xviii]** The term “execution quality” of the intermediary as mentioned in SLC 2.68 refers to the quality of the results that the intermediary has delivered in comparison to the results that were possible. There may be several different aspects or “qualities” of an intermediary’s execution performance, including price, cost, speed and likelihood of execution and settlement each of which may be measurable or otherwise capable of being assessed and compared against other venues. A Licence Holder will take account of these different aspects of execution performance in accordance with the relative importance it has assigned to these factors in its execution policy.

Use of Third Country Intermediaries or Venues For the Execution of Client Orders

- [xix]** Licence Holders are not prohibited from using third country intermediaries or venues which are not subject to MiFID’s best execution requirements. For the purposes of complying with the requirements of SLC 2.63 to 2.69, the Licence Holders should satisfy themselves that those intermediaries or venues have execution arrangements or standards of execution quality that will allow them to comply with the requirements of SLCs 2.54 to 2.62 and 2.70 to 2.71, as applicable. If Licence Holders which transmit client orders for execution to third parties cannot satisfy themselves in this regard, they cannot discharge their obligations in terms of SLCs 2.63 to 2.69 and therefore cannot use such intermediaries or venues.

Choice of a Single Entity for the Execution of Client Orders

- [xx]** A Licence Holder that transmits or places orders with other entities for execution may include a single entity in its policy if it is able to show that this allows it to satisfy the overarching best execution requirement. That is, where a Licence Holder transmits or places orders with a single entity for execution, the Licence Holder should determine that selecting only one entity complies with the overarching best execution requirement. In addition, the Licence Holder should reasonably expect that the entity it selects will enable it to obtain results for its clients that are at least as good as the results that it reasonably could expect from using alternative entities.

## 2 [D] Inducements – [SLC 2.02 and SLC 2.97]

### 2 [D.1] Introduction

In terms of SLC 2.01, a Licence Holder, when providing investment and/or ancillary services to clients, must act honestly, fairly and professionally in accordance with the best interests of its clients. SLC 2.02 sets further requirements in relation to the receipt or payment by a Licence Holder of a fee, commission or non-monetary benefit that could, in certain circumstances place the firm in a situation where it would not be acting in compliance with the principle stated in SLC 2.01

SLC 2.02 must therefore be interpreted in the context of SLC 2.01. **SLC2.02 covers any fee or commission or non-monetary benefit that a Licence Holder may receive or pay in connection with the provision of investment and/or ancillary services to clients.** It sets the required characteristics of these inducements in order for a Licence Holder to act honestly, fairly and professionally in accordance with the best interests of its clients.

The main objective behind the standard licence conditions relating to inducements contained in SLC 2.02 is investor protection. Accordingly, this Guidance Note, which is based on the Recommendations issued by the Committee of European Securities Regulators ('CESR') in May 2007 (Ref: CESR/07-228b), aims to implement this principle by taking into account valid considerations such as the setting of a level playing field between the treatment of financial instruments and business models that are within the scope of application of the SLCs relating to inducements in the Investment Services Rules.

Section 2 [D.8] of this Guidance Note provides some illustrative examples as to the application of the principles contained in this Guidance Note. On the other hand, Section 2 [D.9] contains a flowchart to show the treatment under SLC 2.02 of a fee, commission or non-monetary benefit *received by* a Licence Holder in connection with a service provided to a client. The treatment under SLC 2.02 of a fee, commission or non-monetary benefit *paid by* a Licence Holder in connection with a service provided to a client is illustrated in Section 2 [D.10].

## 2 [D.2] General

- [i] SLC 2.01 requires Licence Holders to act honestly, fairly and professionally in accordance with the best interests of their clients when providing investment services and/or, where appropriate, ancillary services. Other provisions of the Rules provide measures relevant to the same objective. These include the requirements on inducements set in SLC 2.02.
- [ii] Indeed, SLC 2.02 sets further requirements in respect of the general duty to act in accordance with the best interests of clients. It is intended, in particular, to set standards for the payment and receipt by Licence Holders of fees, commissions and non-monetary benefits. This is because such benefits, in some circumstances, place the firm in a situation where it would not be in compliance with the general duty to act in accordance with the best interests of clients. In order to do so, SLC 2.02 applies in relation to the receipt or payment by a Licence Holder of any fee, commission or non-monetary benefit, but applies in a different way to different types. It does not deal with payments made within the Licence Holder, such as internal bonus programmes, even though these could give rise to a conflict of interest covered by SLC 2.97.
- [iii] Inducements are referred to in SLC 2.97 and SLC 2.02. SLC 2.97 sets out minimum criteria that a firm must take into account in identifying relevant types of conflict of interest. SLC 2.02 sets conditions that must be met in order for a fee, commission or non-monetary benefit to be allowed. In doing so, it applies to all fees, commissions and non-monetary benefits that are paid or provided to or by a Licence Holder in relation to the provision of an investment or ancillary service to a client. Therefore, SLC 2.02 should not be treated as applying only to payments or receipts that are made with the purpose or intent to influence the actions of a Licence Holder.
- [iv] SLC 2.02 applies only to items received or provided by a Licence Holder, whereas through the concept of “relevant persons” the standard licence conditions on conflicts of interest also apply to individuals working for the Licence Holder. When a relevant person is acting for the Licence Holder in relation to the provision of an investment or ancillary service to a client SLC 2.02 also applies to items paid by a third party to that relevant person acting in such a capacity. Small gifts and minor hospitality below a level specified in a Licence Holder's conflicts of interest policy are irrelevant for this purpose.
- [v] The scope of application of SLC 2.02 is the same in relation to payments between Licence Holders that are members of the same group as it is to payments between firms that are not members of the same group.



## **Guidance 2 [D.2]**

**As per the above, Licence Holders are advised that:**

**(a)** SLC 2.02 applies to fees, commissions and non-monetary benefits paid by a Licence Holder or received by it in relation to the provision by it of an investment or ancillary service to a client. Such fees, commissions and non-monetary benefits include commissions or fees that may be paid or provided to or by an Licence Holder and which are standard in the market;

**(b)** The application of SLC 2.02 is the same in relation to a payment or non-monetary benefit provided to or made by a legal entity within the same group as the Licence Holder as it is to one provided to or made by any other legal entity.



**2 [D.3] Items provided “to or by the client”.**

- [i]** SLC 2.02(a) provides for circumstances in which a Licence Holder is not prohibited from paying or receiving benefits in relation to an investment or ancillary service provided to a client. The circumstances are where the item is a *“fee, commission or non-monetary benefit paid or provided to or by a client or a person acting on behalf of a client.”*
  
- [ii]** If the client himself negotiates and pays a fee for a service provided by the Licence Holder, then the payment of that fee will be within SLC 2.02 (a). Another clear circumstance will be if someone is acting under a general power of attorney on behalf of the client. The effect in such cases of SLC 2.02 (a) is that the relevant payments will not be subject to SLC 2.02 (b). This will not affect the operation of disclosure under SLC SLCs 2.28 to 2.37 and SLCs 3.09 to 3.23.
  
- [iii]** To consider a payment made or received on behalf of the client under SLC 2.02 (a), the client needs to be aware that this payment has actually been made or received on his behalf. The client may of course give a specific separate instruction to a person to act on his behalf in making or receiving the payment of a fee or commission. This would generally include circumstances in which there is a clear payment instruction, agency agreement, or the other person is acting as a "mere conduit" for the payment.

**Guidance 2 [D.3]**

**As per the above, Licence Holders are advised that:**

SLC 2.02 (a) applies when the payment is made/received by the client or by a person on behalf of the client. This includes where the client pays a Licence Holder’s invoice directly or it is paid by an independent third party who has no relevant connection with the Licence Holder regarding the investment service provided to the client, such as an accountant or lawyer, acting on behalf of the client. A separate, specific instruction issued by the client to the Licence Holder to receive or make a payment on his/her behalf will also be relevant. The fact that the economic cost of a fee, commission or non-monetary benefit is borne by the client is not alone sufficient for it to be considered within SLC 2.02 (a).

**2 [D.4] Proper Fees**

- [i] In terms of SLC 2.02(c), a Licence Holder is entitled to charge and receive proper fees without being considered to be in breach of the duty to act fairly and professionally in accordance with the best interests of the client.
- [ii] In order to be considered a “proper fee”, a payment must satisfy the following two tests:
- (a) it must “*enable or be necessary for*” the provision of the service; and
  - (b) by its nature it cannot give rise to conflicts with the Licence Holder’s duty to act honestly, fairly and professionally in accordance with the best interests of the clients.
- [iii] The test indicated in (b) above needs to be considered in the abstract, that is on the “nature” of the item and not on the basis of whether the result of the payment has been to give rise to such a conflict. If there is a possibility that the receipt of a standard commission or a fee may give rise to conflicts with the Licence Holder’s duty to clients, then it will not pass the test. For example, a standard fee may be such that it can provide an incentive to the Licence Holder to act other than in the best interests of the client because it will be to the Licence Holder’s advantage to make recommendations that will maximize the commissions it will earn.
- [iv] The list of fees indicated in SLC 2.02(c) is not exhaustive. Any items that are of a type which is similar to those indicated therein, which satisfy the two tests indicated in [ii] above, will not be subject to the conditions established in SLC 2.02(b). However, the imposition of such fees would still necessitate disclosure in terms of the SLCs relating to disclosure to clients.

**Guidance 2 [D.4]****As per the above, Licence Holders are advised that:**

The list of items mentioned within SLC 2.02 (c) is not exhaustive, but in considering whether items that are not specifically mentioned also fall within SLC 2.02 (c) the factors that are mentioned within it need to be considered. Of particular importance is whether an item by its nature cannot give rise to conflicts with the Licence Holder's duty to act, honestly, fairly and professionally in accordance with the best interests of its clients.

**2 [D.5]** *Conditions on Third Party Receipts and Payments*

- [i]** SLC 2.02(b) performs two functions:
- (a)** it ensures disclosure of legitimate third party payments and non-monetary benefits that do meet the tests established in SLC 2.02(b)(ii); and
  - (b)** it prohibits certain third party payments and non-monetary benefits which do not meet the tests set out in SLC 2.02(b) (ii).
- [ii]** Unlike payments to and receipts from clients, inducements which are received from or paid to the Licence Holder by third parties, have to meet a number of conditions in order to be allowed under SLC 2.02(b). These are that the item:
- (a)** must be designed to enhance the quality of the relevant service to the client;
  - (b)** must not impair compliance with the Licence Holder’s duty to act in the best interest of the client; and
  - (c)** there must be clear, prior disclosure to the Licence Holder’s client.
- [iii]** These tests are primarily concerned with circumstances in which the client of a Licence Holder will bear the cost of the payment or receipt of a monetary or non-monetary benefit to or by a Licence Holder. In these circumstances, the interest of the Licence Holder and its client are not necessarily the same or aligned. SLC 2.02(b) puts regulatory controls around payments where there is the possibility of detriment to the client.
- [iv]** With respect to the first test referred to in **[ii]** above, the use of the word “*designed*” makes it clear that a judgement about a fee or a payment, or arrangements for fees or payments, can be made at the time the arrangement is proposed, rather than only once a payment has been actually made. Furthermore, such payments may also benefit other clients or groups of clients apart from the particular client that is receiving the investment services. In this case, the requirement “*to enhance the quality of the relevant service to the client*” is met at the level of the service, provided that the other clients or groups of clients are receiving a similar service.
- [v]** The following factors should be considered, among others, in determining whether an arrangement may be deemed to be designed to enhance the quality

of the service provided to the client and not impair the duty of the Licence Holder to act in the best interests of the client:

- (a) the type of investment or ancillary service provided by the Licence Holder to the client, and any specific duties it owes to the client in addition to those under SLC 2.02, including those under a client agreement, if any;
- (b) the expected benefit to the client(s) including the nature and extent of that benefit, and any expected benefit to the Licence Holder; the analysis about the expected benefit, can be performed at the level of the service to the relevant client or clients;
- (c) Whether there will be an incentive for the Licence Holder to act other than in the best interest of the client and whether the incentive is likely to change the Licence Holder's behaviour;
- (d) The relationship between the Licence Holder and the entity which is receiving or providing the benefit (although the mere fact that a group relationship exists does not by itself constitute a relevant consideration );
- (e) The nature of the inducement, the circumstances in which it is paid or provided and whether any conditions attach to it.

**[vi]** The factor indicated in (d) above will be particularly relevant in some cases, for example, if the Licence Holder and the third party have a number of joint or common interests. In these cases, Licence Holders should assess whether these relations are influencing the Licence Holder to act in a way that is not in the best interests of the client.

**[vii]** On factor (c) above, conflicts management measures can help to mitigate the effect of incentives that could influence the Licence Holder to act other than in the best interests of the client. It is important to stress that the conflicts management rules and the inducements rules are complementary and not substitutes or alternatives. Compliance with the conflicts rules does not provide a safe-harbour from the inducements rules. Conversely, compliance with inducements rules does not provide a safe-harbour from the conflicts rules.

**[viii]** The factors mentioned in 2 [D.5] [v] above:

- (a) must be considered as tools to help Licence Holders and MFSA to assess whether the current and future arrangements Licence Holders are considering entering into are consistent with SLC 2.02. The

factors do not represent a “*one-size-fits-all-approach*” and are not intended to apply uniformly to all situations.

- (b) are relevant to both advice-based and non advice-based distribution models, and in general for the provision of all investment and ancillary services. They are indicative criteria only and not strict or exhaustive factors that must be taken into account in all cases. They are not standalone obligations or requirements.

**Guidance 2 [D.5]**

**As per the above, Licence Holders are advised that:**

The following factors should be considered, among others, in determining whether an arrangement may be deemed to be designed to enhance the quality of the service provided to the client and not impair the duty of the Licence Holder to act in the best interests of the client:

- (a) the type of investment or ancillary service provided by the Licence Holder to the client, and any specific duties it owes to the client in addition to those under SLC 2.02, including those under a client agreement, if any;
- (b) the expected benefit to the client(s) including the nature and extent of that benefit, and any expected benefit to the Licence Holder; the analysis about the expected benefit, can be performed at the level of the service to the relevant client or clients;
- (c) whether there will be an incentive for the Licence Holder to act other than in the best interests of the client and whether the incentive is likely to change the Licence Holder’s behaviour;
- (d) the relationship between the Licence Holder and the entity which is receiving or providing the benefit (although the mere fact that a group relationship exists does not by itself a relevant consideration);
- (e) the nature of the inducement, the circumstances in which it is paid or provided and whether any conditions attach to it

**2 [D.6]** *The Application of Recital 39 to the MiFID Implementing Directive*<sup>3</sup>

- [i] Recital 39 of the MiFID Implementing Directive refers to situations where Licence Holders are paid by commissions received from product providers (such as, by the management company of a collective investment scheme). Recital 39 makes it clear that such a type of remuneration can be legitimate, provided that the Licence Holder's advice or general recommendation to its client is not biased as a result of the receipt of that commission. If this condition is met then the advice or recommendation should be considered as having met the condition of being designed to enhance the quality of the service to the client. The other conditions of SLC 2.02(b) – disclosure, and the obligation not to impair compliance with the duty to act in the best interest of the client – must also be met as must other obligations under MIFID as transposed in the Investment Services Rules.
  
- [ii] Recital 39 is limited to a Licence Holder that is giving unbiased investment advice or general recommendations. However, it does not exclude that other cases may be treated in similar terms. An example is where an issuer or product provider pays a Licence Holder for distribution where no advice or general recommendation is provided. In such cases, the Licence Holder will be providing an investment service to its end-clients; in the absence of payment by the product provider or issuer these investment services, most likely, would not be provided; therefore, in the distribution of financial instruments the payments could be seen as being designed to enhance the quality of the service to the client by allowing that investment service being performed over a wider range of financial instruments. The other conditions of SLC 2.02 (b) – disclosure, and, the obligation not to impair compliance with the duty act in the best interest of the client – must also be met as must other obligations under MIFID as transposed in the Investment Services Rules.

**Guidance 2 [D.6]**

**As per the above, Licence Holders are advised that:**

- (a) Recital 39 makes clear that where a Licence Holder provides investment advice or general recommendations which are not biased as a result of the receipt of commission then the advice or recommendations should be considered as having met the condition of being designed to enhance the quality of the service to the client. The other conditions of SLC 2.02 (b) – disclosure, and, the obligation not to impair compliance with the duty to act in the best interests of the client – must be met;
  
- (b) Recital 39 is relevant to cases in which a Licence Holder is giving unbiased investment advice or general recommendations. It is not exhaustive and does not

prohibit other distribution arrangements under which a Licence Holder receives a commission (from, for example, a product provider or issuer) without giving investment advice or general recommendations. For these cases, payments can be seen as being designed to enhance the quality of the service to the client by allowing a given investment service to be performed over a wider range of financial instruments. The other conditions of SLC 2.02 (b) – disclosure, and, the obligation not to impair compliance with the duty act in the best interests of the client – must be met.

**2 [D.7]** Disclosure

- [i] SLC 2.02 (b) recognises clear, prior disclosure to the Licence Holder's client as one of the conditions for permitted receipts or payments paid or provided to or by a third party.
- [ii] It is clear in terms of SLC 2.02 (b) (i) that the information that a Licence Holder should provide includes "*the existence, nature and amount of the fee, commission or benefit, or, whether the amount cannot be ascertained, the method of calculating that amount.*" Hence a generic disclosure which refers merely to the fact that the Licence Holder may or will receive inducements is not sufficient to enable to investor to make an informed decision and therefore will not be considered as meeting the requirements of SLC 2.02(b)(i)
- [iii] Notwithstanding the above, SLC 2.02 allows the Licence Holder to provide a "*summary disclosure*" ("the essential terms of the arrangements relating to the fee, commission or non-monetary benefit in summary form") rather than the full information. This means that the information disclosed must contain enough information to enable the client to relate the disclosure to the particular investment or ancillary service that is provide to him, or the products to which it relates in order to make an informed decision whether to proceed with the investment or ancillary service and, whether to ask the Licence Holder for the full information relating to inducements.
- [iv] In the case of distribution channels where between a product provider and the final client there is at least one further, intermediary, each Licence Holder providing an investment or ancillary service must comply with its obligation of disclosure to its clients in relation to the services it provides.

**Guidance 2 [D.7]****As per the above, Licence Holders are advised that:**

- (a) in order to contain the "essential terms", a summary disclosure must provide adequate information to enable the investor to relate the disclosure to the particular investment or ancillary service that is provided to him, or, to the products to which it relates, to make an informed decision whether to proceed with the investment or ancillary service and, whether to ask for the full information;
- (b) a generic disclosure which explains merely that the Licence Holder will or may receive or pay or provide items within SLC 2.02 (b) is not sufficient to enable a client to make an informed decision and therefore will not be considered as providing the "essential terms of the arrangements" referred to in SLC 2.02;



(c) when a number of entities are involved in the distribution channel, each Licence Holder that is providing an investment or ancillary service must comply with its obligation of disclosure to its clients.

**2 [D.8] Illustrative examples to show the application of SLC 2.02**

**[i]** In order to explain how SLC 2.02 operates, a number of examples are provided below. These illustrate some of the variety of circumstances in which SLC 2.02 is relevant.

**[ii]** The examples deal only with the application of SLC 2.02 in relation to the circumstances they mention and are presented without prejudice to Licence Holder's other obligations under the Investment Services Rules.

**[iii]** The examples are for illustration purposes only; although they are intended to be helpful in assessing cases that arise in practice, each such case must be assessed on its own merits and in accordance with its own circumstances. It is not correct to extrapolate the conclusions reached in these examples without a thorough analysis of the context and specific circumstances of each case.

*I. A client of a Licence Holder agrees a fee of €100 an hour plus disbursements for the service of investment advice. The Licence Holder provides the advice and issues an invoice for 10 hours work €1000 and an additional €200 for disbursements. The client pays the invoice himself or instructs his accountant to pay the invoice.*

The payment is clearly paid by the client or by a person on behalf of the client and as such is within SLC 2.02. No additional requirements under this SLC apply to the arrangements.

*II. A client of a Licence Holder that provides portfolio management services agrees a fee of 1% per annum of assets under management charged pro rata to be paid out of assets under management and that dealing costs such as dealing fees charged by brokers will also be paid out of the client's assets.*

The payments out of the client's funds for the service of portfolio management are clearly paid by the client or by a person on behalf of the client and as such are within SLC 2.02(a). The payment of the dealing fees will amount to payments on behalf of the client within SLC 2.02(a). No additional requirements under SLC 2.02 apply to the arrangements.

*III. A client has agreed with Licence Holder (A) the fee that he will pay to (A). The client could, if he/she wishes in connection with an investment or ancillary service provided by (A), also provide an explicit instruction to (C) to pay the amounts that the client owes to Licence Holder (A) out of the client's account with (C). The client is able to*

*instruct (C) to cease to make such payments.*

Here it is clear that (C) is acting on behalf of its client and the arrangements are within SLC 2.02 (a), and, that (C) is not a "third party" such as to require the tests of SLC 2.02(b) to be met.

- IV. *A client of a Licence Holder that provides portfolio management services agrees a fee of 1% per annum of assets under management charged pro rata to be paid out of assets under management and that dealing costs such as dealing fees charged by brokers will also be paid out of the client's assets. The portfolio manager agrees with one broker that 20% of the dealing fees above a certain level each year will be repaid. These are paid to the portfolio manager.*

The payments to the Licence Holder out of the client's assets for the service of portfolio management are clearly paid by the client or by a person on behalf of the client and as such are within SLC 2.02(a). In this case the portfolio manager has also negotiated a further payment to itself. This receipt by the Licence Holder from a "third party" (the broker) falls within SLC 2.02(b) and in order for the portfolio manager to retain it and not pay it to the client, the tests within SLC2.02 (b) would have to be met. Particularly relevant could be factors (a), (b) and (c) indicated in guidance 2 [D.5] of this Guidance Note. The arrangement entered into by the Licence Holder does not appear to provide any new benefit for the clients of the Licence Holder. The Licence Holder itself receives a benefit and therefore has an incentive to use only the broker offering the payments. Any enhancement of the service provided to the Licence Holder's clients seems unlikely, but the incentive is likely to impair the firm's duty to act in the best interest of its clients (for example, to provide best execution). Hence, this arrangement does not appear to be allowable.

- V. *A Licence Holder provides a portfolio management service to a client and charges a fee for that service. The Licence Holder purchases financial instruments for its client; the provider of those financial instruments pays a commission to the Licence Holder that is paid out of the product charges made to the client.*

The receipt of a commission in addition to the management fees received for the service of portfolio management is clearly of a nature that could impair the Licence Holder's duty to act in the best interests of its client. However, such arrangements are not altogether prohibited. One clear option for the Licence Holder is to repay to its client any commissions received. If the Licence Holder does not wish to do so then special attention has to be paid, since it would be difficult for

portfolio managers to meet the other conditions within SLC 2.02, especially the duty to act in the best interests of the client.

- VI. *A client (C) of a Licence Holder (F) wishes to deal in instruments that (F) does not offer. Therefore (F) introduces (C) to another Licence Holder (A). (C) becomes a client of Licence Holder (A). (A) provides investment services to (C) and charges transaction fees to (C). (A) then pays a share of those fees to the introducing Licence Holder (F).*

The arrangements need to be considered from the perspective of both the paying Licence Holder (A) and the receiving Licence Holder (F).

MFSA's view is that the payment by the Licence Holder (A) will fall within Article SLC 2.02(b), and can be considered to be designed to enhance the quality of the service to the client. The payment to the introducing broker must be disclosed and must not impair the Licence Holder's duty to act in the best interest of the client.

The receipt of a share of Licence Holder A's fees by Licence Holder (F), where received in connection with an investment or ancillary service provided to (C), will fall within SLC 2.02(b). (F) will need to consider carefully whether the arrangements are permitted under SLC 2.02(b) and for this purpose may find the factors set out in guidance 2 [D.5] of this Guidance Note useful. SLC 2.02(b) also requires the receipt of the benefit to be disclosed.

- VII. *A Licence Holder provides investment advice or general recommendations to its client, transmits orders to product providers on behalf of the client and it does not charge a fee to its clients but receives commission from the product providers when it arranges such sales.*

If the *investment* advice or general recommendation is not biased as a result of the receipt of commissions, the receipt should be considered as designed to enhance the quality of the investment advice to the client. The other conditions of SLC 2.02(b) will also have to be met, and **Guidance 2 [D.5]** will be particularly relevant.

- VIII. *As Example VII above, except that the Licence Holder receives an additional one-off bonus (or "override") payment once sales of a particular product reach an agreed level.*

Points (b), (c) and (e) of guidance 2 [D.5] are particularly relevant to such an arrangement, and it is doubtful that SLC 2.02(b) can be satisfied. As sales approach the target level it becomes more likely that

the Licence Holder's advice will become biased towards that particular product, in breach of the duty to act honestly, fairly and professionally in accordance with the best interests of the client.

- IX. A Licence Holder that is not providing investment advice or general recommendations has a distribution or placing agreement with a product provider or issuer to distribute its products in return for commission paid for by the product provider or a member of its group.*

In such a case the Licence Holder will be providing an investment service to its end-clients; in the absence of payment by the product provider or issuer these investment services, most likely, would not be provided; therefore, the payments may be seen as being designed to enhance the quality of the service to the client. The other elements of SLC 2.02(b) must also be met and in considering this and guidance 2 [D.5] (c) of this Guidance Note in particular may be relevant.

- X. A Licence Holder is providing the ancillary service of corporate finance advice (falling within Section B (3) of Annex I of MiFID). In doing so it incurs its own costs such as fees for legal advice which it does not recharge to its client.*

These costs are permissible under SLC 2.02 (c).

- XI. A product provider provides (without charge) training to the staff of an investment adviser that is a Licence Holder.*

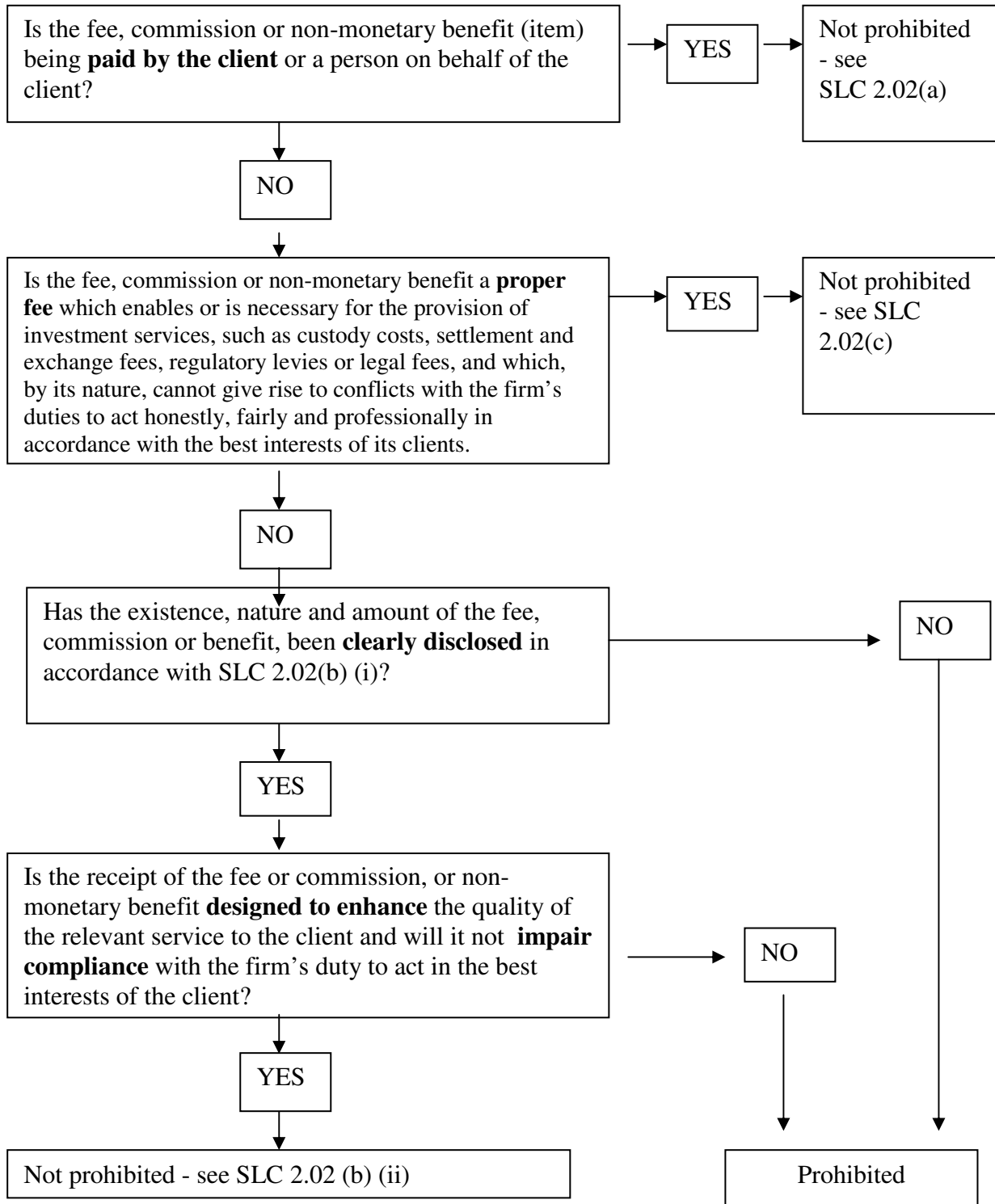
Such training will be a non-monetary benefit provided to the Licence Holder and most likely within SLC 2.02(b). The factors indicated under (b), (c) and (e) of point guidance 2 [D.5] will be relevant, for example, the extent to which the training is in relation to services provided to the clients. Training that is provided in an exotic holiday location paid for by the provider is more likely to impair the Licence Holder's duty to act in the best interests of the client and so not be permitted.

- XII. A broker provides to a Licence Holder general office equipment such as computer equipment.*

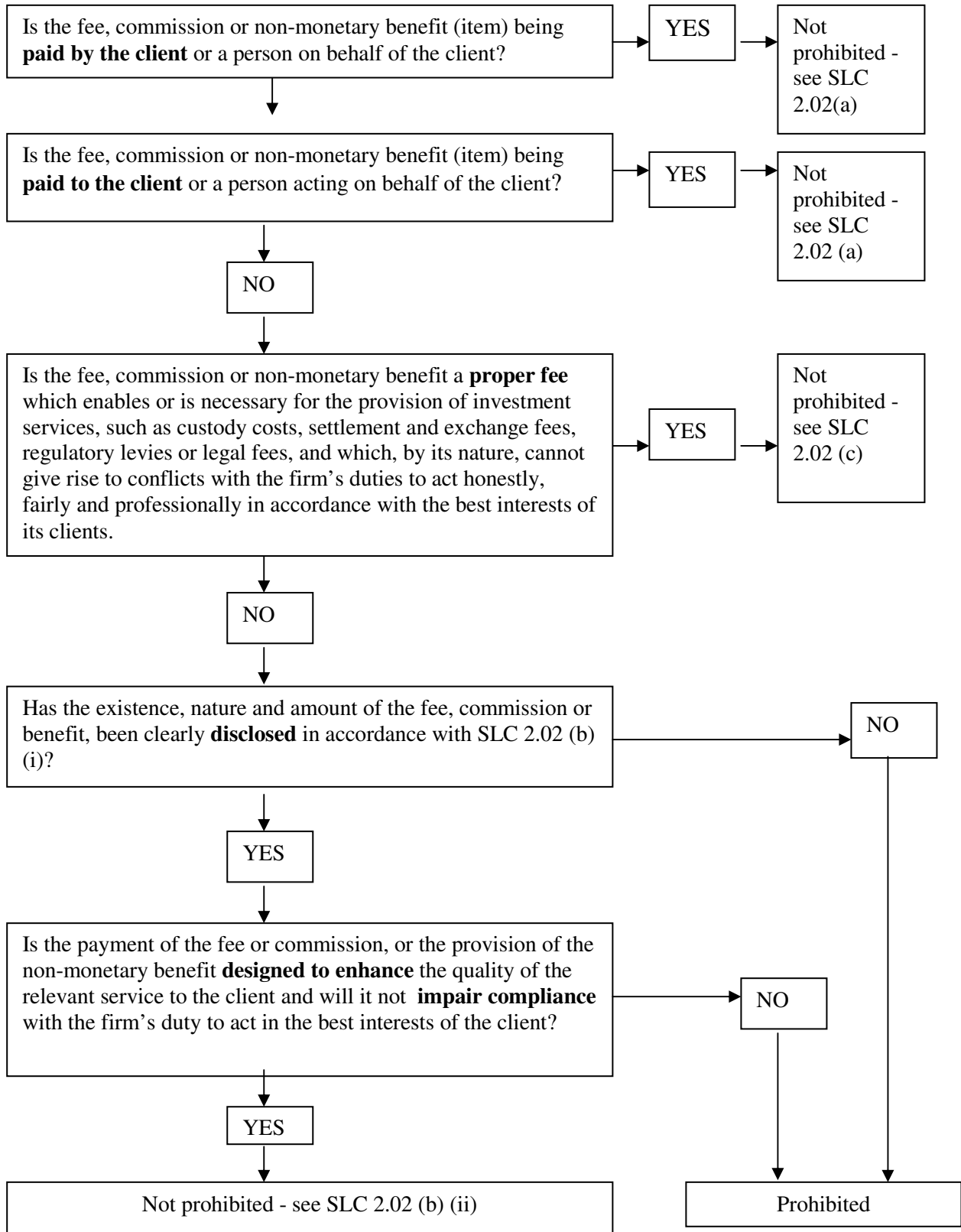
The office equipment will be a non-monetary benefit provided to the Licence Holder and most likely within SLC 2.02(b) of the Level 2 Directive. The factors indicated in (b), (c) and (e) of guidance 2 [D.5] will likely be relevant. Assessment of such items will vary on a case by case basis, depending on all the circumstances. Where equipment

provided is closely related to services provided to clients then its provision to a Licence Holder is more likely to be permitted. Where it is "general" office equipment that can be used for a wide range of purposes within the firm, then assessment against the factors indicated in guidance 2 [D.5], is more likely to lead to a conclusion that the item should not be permitted.

2 [D.9] Treatment under SLC 2.02 of a fee, commission or non-monetary benefit received by a Licence Holder in connection with a service provided to its client



**2 [D.10]** *Treatment under SLC 2.02 of a fee, commission or non-monetary benefit paid to a firm in connection with a service provided to its client*





## 2 [E] Safeguarding of clients assets – [SLCs 2.86 – 2.93]

This section of the Investment Services Rules outlines the requirements which are to be complied with for the purpose of safeguarding client's rights in relation to financial instruments and money belonging to them which are held or controlled by Licence Holders.

The aim of this Guidance Note is to provide Licence Holders with guidance on the manner in which certain aspects of the requirements emanating from these SLCs may be implemented.

### 2 [E.1] Clients' Money / Assets Reconciliations – [SLCs 2.86 (c)]

[i] SLC 2.86 (c) requires reconciliations on a regular basis of clients' assets including money. In this regard it is recommended that:

#### (a) Clients' Money:

The balance on each clients' money bank account as recorded by the Licence Holder is reconciled monthly with the balance on that account as set out in the statement issued by the bank. For the sake of good order, it is also suggested that such reconciliations are carried out within two weeks from the month's end.

Furthermore, in tandem with the above, it is recommended that the total of the balances on all clients' money bank accounts as recorded by the Licence Holder is reconciled with the total of the corresponding credit balances in respect of each of its clients, as recorded by the Licence Holder.

#### (b) Clients' Assets:

Physical counts and inspections of clients' financial instruments and the subsequent reconciliation of all such assets with customers' records is carried out at least twice a year.

Where the Licence Holder discovers discrepancies after carrying out the above reconciliations, it is suggested that a record is maintained of such discrepancies and the measures taken to remedy such differences.

**2 [E.2]** *Clients' Money / Assets Reconciliations – [SLCs 2.86 (d) & (e)]*

- [i]** SLC 2.86 (d) & (e) requires the Licence Holder to hold an account /accounts identified separately from any accounts used to hold money/financial instruments belonging to the Licence Holder. In this regard, it is suggested that clients' money/financial instruments are held in specially created and segregated accounts entitled "***Client Money Account***"/ '***Client Financial Instruments Account***' on trust for the customer.
  
- [ii]** Furthermore, it is recommended that the Licence Holder obtains from the Bank/Custodian a declaration in writing that the latter renounces and will not attempt to enforce or execute, any charge, right of set-off or other claim against the account, or combine the account with any other account in respect of any debt owed to the Bank/Custodian by the Licence Holder, and that interest payable on the account will be credited to the account. It is advisable for the Licence Holder to obtain such confirmation from the Bank/Custodian upon the opening of such account.

## 2 [F] **Conflicts of Interest Policy – [SLCs 2.94 – 2.100]**

Standard licence conditions 2.94 - 2.100 of the Investment Services Rules require Licence Holders to identify and effectively manage their conflicts of interest and where this is not possible to clearly disclose the nature and/or sources of conflicts of interest to the client before undertaking business on its behalf.

The purpose of this Guidance Note is to assist Licence Holders in ensuring compliance with the conflicts of interest requirements set in the above-mentioned standard licence conditions by applying the following **four** tier approach:

- ◆ Identification of conflicts of interest;
- ◆ Conflicts of Interest Policy;
- ◆ Disclosure; and
- ◆ Recording Conflicts of Interest.

### 2 [F.1] *Identification of Conflicts of Interest*

[i] In terms of SLC 2.95, Licence Holders must have appropriate internal procedures in place aimed at identifying conflicts of interest between:

- (a) themselves [including their managers, employees or any person directly or indirectly linked to them by control] **and** their clients;
- (b) between one client **and** another, which arises in the course of providing any investment and ancillary services; and
- (c) a combination of the above two possible scenarios

and which may arise in the course of providing investment and ancillary services or a combination thereof and whose existence may damage the interests of the client.

[ii] In the course of identifying such conflicts of interest, the Licence Holders must in terms of SLC 2.97 take into account the question whether itself or a relevant person [as defined in the glossary of terms of the Rules], or a person directly or indirectly linked by control to the Licence Holder, falls within any of the following situations:

- (a) the Licence Holder or that person is likely to make a financial gain,

or avoid a financial loss at the expense of the client;

- (b) the Licence Holder or that person has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;
- (c) the Licence Holder or that person has a financial or other incentive to favour the interests of another client or group of clients over the interests of the client;
- (d) the Licence Holder or that person carries on the same business as the client; and
- (e) the Licence Holder or that person receives or will receive from a person other than the client, an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.

[iii] Once the Licence Holder identifies the said conflicts of interests, in terms of SLC 2.94 and 2.96, Licence Holders are to **adopt effective systems and controls** in the form of procedures aimed at either:

- (a) preventing the possibility of such conflicts of interest from adversely affecting the interest of its clients [managing conflicts of interest- i.e. ensuring that relevant persons engaged in different business activities involving a conflict of interest of the kind identified by the Licence Holder, carry on those activities at a level of independence appropriate to the size and activities of the Licence Holder]; or
- (b) where this is not possible to clearly disclose the nature and/or sources of conflicts of interest to the client before undertaking the business on its behalf.

**2 [F.2]**    *Conflicts of Interest Policy*

- [i]**        In terms of SLC 2.98 Licence Holders are required to prepare a conflicts of interest policy.
- [ii]**        As per SLC 2.99/2.100 the **aim** of such policy is that of recording in a written document:
- (a)**        the conflicts of interests identified by the Licence Holder as per above; and
  - (b)**        the procedures to manage such conflicts, which procedures should include such of the following as are necessary and appropriate for the Licence Holder to ensure the requisite degree of independence between relevant persons engaged in different business activities involving a conflict of interest:
    - ◆ effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;
    - ◆ the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the Licence Holder;
    - ◆ the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;
    - ◆ measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out investment or ancillary services or activities; and
    - ◆ measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate investment or ancillary services or activities where such involvement may impair the proper management of conflicts of interests.

## **2 [G] Complaints Handling – [SLC: 2.117]**

In terms of SLC 2.117, the Licence Holder is required to:

- (a)** establish, implement and maintain effective and transparent procedures for the reasonable and prompt handling of complaint received from retail clients or potential retail clients;
- (b)** keep a record of each complaint and the measures taken for its resolution; and
- (c)** inform complainants that they may refer their complaint to the MFSA's Consumer Complaints Unit if they are not satisfied with the manner in which it has been handled by the Licence Holder.

The purpose of this Guidance Note is to provide Licence Holders with guidance as the manner in which the above mentioned requirements could be implemented.

### **2 [G.1] Maintenance of Complaints Register**

- [i]** Licence Holders are advised to set up a “Complaints Register” in which every complaint and the action taken in its regard are recorded. In such a register it is advisable for Licence Holders to also keep a record of the date when the complaint was received and the date on which it was resolved.
- [ii]** MFSA may require sight of such register, if any, at any time, in particular during its compliance visits. In the absence of such a register MFSA could request Licence Holders to explain the manner in which the record keeping requirement set in SLC 2.117 is being satisfied by the Licence Holder.

## 2 [G.2] Complaints Handling Procedure

When receiving a complaint, it is advisable for Licence Holders to follow the procedure outlined below. It is recommendable for Licence Holders to also refer to the procedures lodged on the MFSA's Website (<http://www.mfsa.com.mt/consumer/complaints.htm>).

- [i] Retain a record of each complaint as soon as it is received and of the action taken in that regard.
- [ii] Within seven business days acknowledge receipt of any complaints received.
- [iii] Where a complaint is made orally – make a summary of the complaint and ask the complainant to confirm in writing the said summary.
- [iv] The letter of acknowledgement should confirm that:
  - (a) the Licence Holder will investigate the complaint;
  - (b) on completion of the investigation, the Licence Holder will write to the complainant concerning the outcome; and
  - (c) if within two months after receipt of the complaint the investigation has not been completed, the Licence Holder must inform the complainant in writing.
- [v] In respect of point (b) above - send the complainant a letter explaining the outcome of the investigation.

If the Licence Holder considers it appropriate to take remedial action, describe the proposed course of action in the letter.

In the same letter inform the complainant that s(he) may refer the complaint to the MFSA's Consumer Complaints Unit if s(he) is not satisfied with the manner in which the complaint has been handled by the Licence Holder.

- [vi] If within two months after receipt of the complaint, the investigation has not been completed - inform the complainant in writing within seven business days of the end of that period.

In the letter explain clearly that the investigation of the complaint will continue and that if the complainant is not satisfied with the progress of the investigation, (s) he may refer the matter to the MFSA.

## 2 [G.3] Dispute Settlement

- [i] MFSA encourages Licence Holders to promote the services offered by the MFSA consumer complaints office. However, Licence Holders should not overlook arbitration as a means of settling a dispute that has otherwise proved to be insoluble
  
- [ii] In cases where the services offered by the MFSA consumer complaints office are not available (for example, where the complainants are not individuals), it is advisable that the Licence Holder offers alternative means of settling a dispute, such as arbitration or a tribunal where appropriate.

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<sup>3</sup> Commission Directive 2006/73/EC of 10 August 2006 implementing Directive 2004/39/EC of the European Parliament and of the Council as regards organisational requirements and operating conditions for Licence Holders and defined terms for the purposes of the Directive.



## **GUIDANCE NOTES**

### **TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

#### **GUIDANCE NOTE NO. 3**

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#### **Disclosure Requirements for Information to Clients Including Marketing Communications – [SLCs 3.01 – 3.23]**

##### **3 [A] Introduction:**

Section 3 of the Investment Services Rules *inter alia* transposes and implements the provisions of MiFID and the Implementing Directive which deal with marketing communications. The aim of this document is to provide the industry with guidance on the manner in which Licence Holders may implement Investment Services Rules SLCs 3.01 to 3.09.

It is recommendable for Licence Holders to use these Guidance Notes as a means of fulfilling their obligations as stipulated in SLCs 3.01 - 3.09 of the Investment Services Rules.

##### **3 [B] Overview of Guidance Note:**

This Guidance Note is divided into different sections namely:

- 3 [B.1] Applicability of Rules 3.01- 3.09 and this Guidance Note
- 3 [B.2] Definitions
- 3 [B.3] SLC 3.01 - Fair, Clear and not Misleading Information
- 3 [B.4] SLC 3.02 - Details to be included in all Information
- 3 [B.5] SLC 3.03 - Information Comparing Investment or Ancillary Services, Financial Instruments, or Persons Providing Investment or Ancillary Services
- 3 [B.6] SLC 3.04 - Information Containing Past Performance Indicators

- 3 [B.7] SLC 3.05 - Information Containing Future Performance Indicators
- 3 [B.8] SLC 3.06 - Information Containing Simulated Past Performance
- 3 [B.9] SLC 3.07 - Information referring to Tax Treatment
- 3 [B.10] Additional Guidance on Marketing Communications
- 3 [B.11] Issuing and Approving Marketing Communications

**3 [B.1]** Applicability of SLCs 3.01 - 3.09 and this Guidance Note

- [i]** SLCs **3.01- 3.09** and this Guidance Note are applicable to those investment services Licence Holders, irrespective of their licence category, who produce and/ or disseminate any information or material, via any medium, which falls within the scope of the definition of ‘*investment advertisement*’ as defined by the ISA and which is likely to be received by, existing or potential clients or investors [‘**clients**’].
- [ii]** Standard licence conditions **3.01- 3.09** and this Guidance Note **do not apply** to Licence Holders which produce or disseminate information which consist only of one or more of the following:
  - (a)** the name of the firm;
  - (b)** a logo or other image associated with the firm;
  - (c)** a contact point;
  - (d)** a reference to the types of investment services provided by the firm;
  - (e)** reference to the investment firm’s charged fees or commissions

**3 [B.2]** Definitions

**[i]** **Article 2(1)** of the Investment Services Act, 1994 [**'ISA'**] defines an *'investment advertisement'* as:

*'Any form or medium of advertising or promotional activity, other than a prospectus, the contents of which, either invites persons, or contains material calculated to induce persons:*

- (i) to become or offer to become participants in a collective investment scheme; or*
- (ii) to subscribe for or otherwise acquire or underwrite an instrument; or*
- (iii) to purchase or otherwise procure an investment service.'*

**[ii]** **Article 11(1b)** of the ISA provides that *'no person, other than licence holders, may issue or cause to be issued an investment advertisement in or from within Malta unless its contents have been approved by a licence holder'*

**[iii]** *'Investment advertisement'* as defined by the ISA and *'marketing communications'* as described by the Investment Services Rules, should be construed to mean and refer to one and the same.

**[iv]** *'Information'* as used in this document should be construed to mean and refer to all types of marketing communication as well as all other types of information produced and disseminated by the Licence Holder to potential or existing clients. This therefore includes information disseminated to existing and potential clients via all types of media including amongst others newspapers, magazines, billboards, the World Wide Web and mail-shots.

### 3 [B.3] SLC 3.01- Fair, Clear and not Misleading Information

- [i] **SLC 3.01** stipulates that '**All information**, including marketing communications addressed by the Licence Holder to clients or potential clients shall be fair, clear and not misleading'. **SLC 3.01** also stipulates that Licence Holders should clearly identify marketing communications from other types of information. **SLC 3.02- 3.09**, in turn, specify with broad detail the conditions which Licence Holders are advised to follow to fulfil the provisions of **SLC 3.01**. To this effect, the sections below aim at providing guidance on the manner in which the provisions of **SLC 3.02 - 3.09** may be implemented.
- [ii] For the purpose of **SLC 3.01**, '*information*' should be considered to be '*misleading*' if it has a tendency to mislead the person or persons to whom it is addressed or by whom it is likely to be received, whether or not the person who provides the information considers or intends it to be misleading.
- [iii] In addition to marketing communications being fair, clear and not misleading, in terms of **SLC 2.37**, Licence Holders are required to ensure that information contained in a marketing communication, is consistent with any information the Licence Holder provides to clients in the course of carrying on investment or ancillary services.

**3 [B.4]** SLC 3.02- Details to be included in all information

For the purposes of satisfactorily implementing all the provisions of **SLC 3.02** of the Investment Services Rules, the following guidance should be noted:

**[i]** SLC 3.02 (a): the name of the Licence Holder should be construed to mean the full name of the Licence Holder and preferably include the registered address of the Licence Holder;

**[ii]** SLC 3.02 (b): in terms of this SLC *'the information should be accurate, and in particular shall not emphasise any potential benefits of an investment service or financial instrument without also giving a fair prominent indication of the any relevant risks'*. In order to comply with this Licence Condition it is advisable for Licence Holders:

**(a)** to ensure that the information provided does not take advantage of any particular characteristics of the Licence Holder and/or the services it renders and/or of the investment product marketed e.g. the information should not emphasise performance figures or potential regular returns;

**(b)** to compile and approve information in light of the product prospectus and any other product documentation to ensure that the information provided is not in conflict, in any way, with any product documentation.

**e.g.** Phrases similar to or derivatives of *'fixed annual income'*, *'minimum return'*, *'monthly distributions'* amongst others may only be used if in accordance with the provisions of the product prospectus.

**(c)** to ensure that the terminology used to describe the rate of return is adequate terminology for that particular investment  
e.g. when quoting rates of return for bond funds the term *'yield'* should be used to describe such a return in lieu of *'interest rate'* or *'return'*.

Care must also be exercised in using the correct terminology when advertising in Maltese so that the term *'rata ta' imghax'* is only used where appropriate as opposed to *'qligh'*;

**(d)** to ensure that an investment is only described as *'guaranteed'* or *'partially guaranteed'* only if the advert gives a description of: **[i]** the

name and a description of the guarantor; **[ii]** the legally binding nature of the guarantee and to what it relates; and **[iii]** and whether there are any matters which may affect the investor's ability to benefit from it.

(e) to ensure that all necessary and appropriate disclaimers, warnings and footnotes are included. In this regard, it is recommendable for a Licence Holder to include, where applicable, the following disclaimers:

- ◆ *'This advert has been issued by [Licence Holder's Name]';*
- ◆ *'[Licence Holder's Name] is licensed to provide investment services in Malta by the Malta Financial Services Authority';*
- ◆ *[where illustrations or any other references to performance figure is used] 'the [yield or other terminology used to indicate the return] is not guaranteed and may go down as well as up';*
- ◆ *[where information which suggests payments to investors on a regular basis is used] 'the frequency of payments is not guaranteed and may vary';*
- ◆ *[where a prospectus exists] 'Investment should be based on the full details of the prospectus';*

**[iii]** SLC 3.02 (c): provides that information *'be sufficient for, and presented in a way that is likely to be understood by, average member of the group to whom it is directed, or by whom it is likely to be received'*. In this regard to comply with this Licence Condition it is recommendable for Licence Holders to ensure that the content and format of the information should be presented in a way which is easily understood by the average person and should not be presented in a way which may cause it or its contents to be misunderstood. Therefore, where possible, simple and accurate terms should be used as opposed to complicated and technical jargon.

**[iv]** SLC 3.02 (d): provides that information shall not disguise, diminish or obscure important items, statements or warnings. In order to comply with this Licence Condition it is recommendable for Licence Holders:

(a) to take account of the means of communication used to communicate the information to clients and of the limitations and/ or disadvantages associated with a particular means of communication. To this effect **Guidance Note [3.B.10]** should be noted for additional guidance with respect to publication of information on different types of media;

- (b)** to ensure that disclaimers, risk warnings and other footnotes used in the information should be of sufficient size and prominence to be clearly legible and not diminished, disguised or obscured in any way by the content, design or format of the information;
- (c)** to ensure that quoted performance figures are not selected so as to exaggerate the success or disguise the lack of success of the investment;
- (d)** to include a statement in the information regarding any significant position or holding in the product which is the subject of the information;

**3 [B.5]** *SLC 3.03 - Information Comparing Investment or Ancillary Services, Financial Instruments, or Persons Providing Investment or Ancillary Services*

For the purposes of satisfactorily implementing all the provisions of **SLC 3.03** of the Investment Services Rules, the following guidance should be noted:

- [i]** SLC 3.03 (a): in terms of this SLC a '*comparison must be meaningful and presented in a fair and balanced way*'. In order to comply with this Licence Condition it is recommendable for a Licence Holder to ensure that the information sets out clearly the different features of each product in such a way that investors can clearly distinguish between the products.
- [ii]** SLC 3.03 (b): in terms of this SLC '*the sources of the information used for the comparison must be specified*'. In order to comply with this Licence Condition it is recommendable for Licence Holders to ensure that comparisons or contrasts are based either on facts verified by the Licence Holder or on reasonable assumptions stated within the information.
- [iii]** SLC 3.03 (c): in terms of this SLC '*the key facts and assumptions used to make the comparison must be included*'. In order to comply with this Licence Condition it is recommendable for Licence Holders to ensure that comparisons or contrasts do not omit anything material to the comparison or contrast.



**3 [B.6]** SLC 3.04- Information Containing Past Performance Indicators

For the purposes of satisfactorily implementing all the provisions of **SLC 3.04** of the Investment Services Rules, the following guidance should be noted:

- [i]** SLC 3.04 (a): in terms of this SLC '*indication [of past performance] must not be the most prominent feature of the communication*'. Performance figure/s (including the use of graphs or other phrases used in the information which could give an indication of the rate of return) are considered to be the most prominent feature of the information when the font size/s used to illustrate the performance figure/s **[a]** is larger than that used for any other item of information within the same communication; **[b]** is disproportionate to the font size used for any other item of information including the disclaimers, footnotes, warnings; and **[c]** gives the performance rate excessive prominence;
- [ii]** SLC 3.04 (b): in terms of this SLC '*the information must include appropriate performance information which covers the immediately preceding 5 years ... and in every case that performance information must be based on complete 12 month periods*'. Therefore Licence Holders must ensure that all performance figures quoted in the information are annualised. In addition, it is recommendable for Licence Holders, which annualise a rate of return using figures which do not span over a year, to clearly disclose the basis period over which the annualised rate is calculated and to include the disclaimer: '*the annualised rate is an indication of the average growth of the investment over one year*';
- [iii]** SLC 3.04 (c): in terms of this SLC '*the reference period and the source of information must be clearly stated*'. Licence Holder should ensure that the reference period and the source of information is quoted even when disclosing and/ or illustrating past performance figures or indicators in pie charts or any other types of graphs or illustrations.
- [iv]** SLC 3.04 (d): in terms of this SLC '*the information must include a prominent warning that the figures refer to the past and that past performance is not a reliable indicator of future results*'. It is recommended that Licence Holders use '*The performance figures quoted refer to the past and past performance is not a guarantee of future performance or a reliable guide to future performance*' as the applicable warning.
- [v]** SLC 3.04 (e): in terms of this SLC '*where the indication relies on figures denominated in a currency other than that of the country in which the retail client or potential client is resident .....together with a warning that the return may increase or decrease as a result of currency fluctuations*'. It is

recommended that Licence Holders use *'This [product] may be affected by changes in currency exchange rate movements thereby affecting your investment return therefrom'* as the applicable warning.

[vi] SLC 3.04 (f): in terms of this SLC *'where the indication is based on gross performance, the effect of commissions, fees or other charged must be disclosed'*. In order to comply with this SLC Licence Holders may either quote performance figures:

- (a) net of all applicable fees and charges; or
- (b) gross, but clearly highlighting all applicable fees and charges in the information disclaimers which could have an impact on the value of the quoted performance e.g.:
  - ◆ for instruments subject to front- end fees: *'A commission or sales fee may be charged at the time of the initial purchase for an investment and may be deducted from the invested amount therefore lowering the size of your investment'*;
  - ◆ for instruments subject to exit fees: *'A fee may be charged at the time you redeem your investment [or if you wish to withdraw your investment in the early period] which may have an impact on the amount of money you receive'*.

**3 [B.7]**    SLC 3.05- Information Containing Future Performance Indicators

For the purposes of satisfactorily implementing all the provisions of **SLC 3.05** of the Investment Services Rules, the following guidance should be noted:

**[i]**    SLC 3.05 (a): in terms of this SLC ‘*the information must not be based on or refer to simulated past performance*’. It is recommended that Licence Holders do not illustrate future performance figures in a way which indicates or gives the impression that the future performance of the investment is correlated in any way to the past performance of the investment.

**[ii]**    SLC 3.05 (c): in terms of this SLC ‘*where the indication is based on gross performance, the effect of commissions, fees or other charged must be disclosed*’. In order to comply with this SLC, Licence Holders may either quote performance figures:

- (a)**    net of all applicable fees and charges; or
- (b)**    gross, but clearly highlighting all applicable fees and charges in the information disclaimers which could have an impact on the value of the quoted performance e.g.:

- ◆    for instruments subject to front- end fees: ‘*A commission or sales fee may be charged at the time of the initial purchase for an investment and may be deducted from the invested amount therefore lowering the size of your investment*’;
- ◆    for instruments subject to exit fees: ‘*A fee may be charged at the time you redeem your investment [or if you wish to withdraw your investment in the early period] which may have an impact on the amount of money you receive*’.

**[iii]**    SLC 3.05 (d): in terms of this SLC such information ‘*must contain a prominent warning that such forecasts are not a reliable indicator of future performance*’. It is recommended that Licence Holders use ‘*The performance figures quoted should only be considered as forecasts and may not be a reliable indicator of future performance of this investment*’ as the applicable warning.

**3 [B.8]** SLC 3.06- Information Containing Simulated Past Performance

For the purposes of satisfactorily implementing all the provisions of **SLC 3.06** of the Investment Services Rules, the following guidance should be noted:

- [i]** SLC 3.06 (b): the guidance noted in 3.B.6 [i] - [iii], [v] and [vi] above should be considered as relevant guidance for the implementation of this SLC.
- [ii]** SLC 3.06 (c): in terms of this SLC *'the information must contain a prominent warning that the figures refer to simulated past performance and that past performance is not a reliable indicator of future performance.'* Licence Holders are recommended to use *'The performance figures quoted are only estimates and may not be a reliable indicator of future performance of this investment'* as the applicable warning.

**3 [B.9]** *SLC 3.07- Information Referring to Tax Treatment*

For the purposes of satisfactorily implementing all the provisions of **SLC 3.07** of the Investment Services Rules which SLC states that *‘where the information refers to a particular tax treatment, it shall prominently state that the tax treatment depends on the individual circumstances of each client and may be subject to change in the future’*, It is recommended that Licence Holders use *‘The levels and bases of taxation are dependent on individual circumstances and subject to change and therefore it is highly recommended that you consult a professional tax adviser’* as the applicable warning.

**3 [B.10]** *Additional Guidance on Marketing Communications***[i]** Information Broadcasted on Television and Radio:

With respect to information broadcasted on television and radio, apart from the recommendations made in the above-section of this Guidance Note, it is recommendable for Licence Holders to:

- (a) have clear and legible risk warnings indicated on a caption at the very bottom of the visual which should take up not less than 20% of the whole screen;
- (b) indicate the captions on a black background and using bold, white text which is non italicised. Captions at the bottom of the screen should not exceed 4 lines each and should only be updated at intervals of not less than 4 seconds each during broadcast of the visual;
- (c) include a voice over of all the relevant risk warnings relative to the investment;
- (d) not include any reference to past or future performance rates if the broadcast is less than 30 seconds long.

**[ii]** Information Disseminated via the World Wide Web

With respect to information disseminated via the World Wide Web, apart from the recommendations made in the above-section of this Guidance Note, it is recommendable for Licence Holders to:

- (a) where the website is being targeted to particular consumer groups, include a statement indicating to which consumer groups the website is being targeted;
- (b) include appropriate statements that the investor is leaving the Licence Holder's website and accessing another in cases where the Licence Holder's website is hyperlinked to other sites.

**3 [B.11] Issuing and Approving Marketing Communications**

In order to ensure that all marketing communications issued by the Licence Holder comply with the relevant SLCs and that therefore such marketing communications are fair, clear and not misleading, it is recommended that Licence Holders:

- (a) adopt an internal procedure wherein an officer of the company, preferably the Compliance Officer, approves marketing communications on its behalf;
- (b) keep records of all information issued and approved, including
  - ◆ the name of the individual who approved the communications;
  - ◆ the date of approval of the information;
  - ◆ the publications in which the investment advertisement was included; and
  - ◆ evidence of support to any statement made in the information which is not a statement of fact.

**3 [B.12]** *Reviewing the Compliance of Marketing Communications*

- [i]** Once a Licence Holder approves and/or issues information, by virtue of its compliance monitoring duties, the MFSA assesses whether such information is fair, clear and not misleading and in line with the provisions of **SLC 3.01- 3.09** as **further explained in this Guidance Note**. If marketing communication is deemed to be unfair, unclear, or misleading or not compliant with the above-mentioned SLCs, the MFSA may take any of the following steps:
- (a)** ask the Licence Holder to withdraw the advert before further publication is allowed;
  - (b)** ask a Licence Holder to amend the advert for future publication;
  - (c)** if the information is considered to be seriously misleading, the MFSA may ask the Licence Holder to contact consumers who have invested after responding to the information and offer such clients the opportunity to withdraw at no cost or undertake any other measure which the MFSA deems fit and appropriate at the time;
  - (d)** if a Licence Holder seriously or persistently breaches the Investment Services SLCs **3.01- 3.09** **as further explained in this Guidance Note**, the MFSA may impose an administrative penalty on the Licence Holder in terms of its powers under Article 6 (9) of the Investment Services Act, 1994 and include the fine and name of the Licence Holder in question on the MFSA's official website.
- [ii]** It is reiterated that the MFSA does not at any time or under any circumstance approve the content or format of adverts prior to their issue. Therefore, it reserves the right to exercise its regulatory powers and to take action, at any time and in any way it deems fit and appropriate, against Licence Holders if it considers that the requirements of the Investment Services Rules have not been complied with. This right applies under all circumstances, irrelevant of whether the MFSA has issued guidance in respect of a particular standard licence condition (or provision thereof) or otherwise.



## **GUIDANCE NOTES**

### **TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

#### **GUIDANCE NOTE NO. 4**

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#### **Outsourcing – [SLCs 4.01 to 4.11]**

The contents of this Guidance Note are based on the Guidelines for Outsourcing issued by Committee of European Banking Supervisors ('CEBS') on the 29<sup>th</sup> November 2006. In process leading to the issue of these guidelines, CEBS and the Committee of European Securities Regulators (CESR) have ensured that the proposed guidelines are consistent with the Markets in Financial Instruments Directive (MiFID) and its application to credit institutions.

**Guidance Note 4 has the aim of providing Investment Services Licence Holders with further guidance as to the extent to which they can outsource some of their activities and the manner in which this can be done.**

#### **Definitions**

Words and expressions which are also used in the Investment Services Rules shall have the same meaning as defined in the Glossary thereto. In addition, for the purposes of this Guidance Note, the following definitions shall apply:

**“outsourcing”**: a Licence Holder’s use of a third party (the “outsourcing service provider”) to perform activities that would normally be undertaken by the Licence Holder, now or in the future. The supplier may itself be an authorised or unauthorised entity;

**“purchasing”**: *inter alia*, the supply:

- (i) of services, goods or facilities without information about, or belonging to, the purchasing institution coming within the control of the supplier; or
- (ii) of standardized products, such as market information or office inventory. (Licence Holders should ensure that what they are buying is fit for purpose.);

**“outsourcing service provider”**: the supplier of goods, services or facilities, which may or may not be an authorised entity, and which may be an affiliated entity within a corporate group or an entity that is external to the group;

**“outsourcing Licence Holder”**: the Licence Holder which is the buyer of such goods, services or facilities

**“material activities”**:

- (i) activities of such importance that any weakness or failure in the provision of these activities could have a significant effect on the Licence Holder’s ability to meet its regulatory responsibilities and/or to continue in business;
- (ii) any other activities requiring a licence from the MFSA;
- (iii) any activities having a significant impact on its risk management; and
- (iv) the management of risks related to these activities.

**“senior management”**: persons who effectively direct the business of the Licence Holder;

**“chain outsourcing”**: outsourcing where the outsourcing service provider subcontracts elements of the service to other providers.

**4 [A] Responsibilities.**

**4 [A.1] Responsibility for the Proper Management of the Risks Associated with Outsourcing or Outsourced Activities.**

- [i]** As required by SLC 4.01, all outsourcing regimes should ensure that the outsourcing of functions to an outsourcing service provider does not impair the supervision of the outsourcing Licence Holder.
- [ii]** Responsibility for outsourced functions must always be retained by the outsourcing Licence Holder (SLC 4.04). The outsourcing of functions does not relieve an outsourcing Licence Holder of its regulatory responsibilities for its licensable activities or the function concerned.
- [iii]** The ultimate responsibility for the proper management of the risks associated with outsourcing or the outsourced activities lies with an outsourcing Licence Holder's senior management.
- [iv]** Outsourcing Licence Holders should be required to retain adequate core competence at a senior operational level in house to enable them to have the capability to resume direct control over an outsourced activity, *in extremis*.

## 4 [A.2] Responsibility of Senior Management of an Outsourcing Licence Holder

- [i] In terms of SLC 4.04(a) Outsourcing arrangements can never result in the delegation of senior management's responsibility.
  
- [ii] The outsourcing of core management functions is considered generally to be incompatible with the senior management's obligation to run the enterprise under their own responsibility. Core management functions include, inter alia, setting the risk strategy, the risk policy, and, accordingly, the risk-bearing capacity of the institution. Hence, management functions such as the setting of strategies and policies in respect of the Licence Holder's risk profile and control, the oversight of the operation of the Licence Holder's processes, and the final responsibility towards customers and supervisors should not be outsourced.

## **4[B] Activities.**

### **4 [B.1] Activities Which May be Outsourced**

- [i]** A Licence Holder may not outsource service and activities concerning licensable activities unless the outsourcing service provider either:
- (a)** has an equivalent authorisation of the Licence Holder outsourcing the services); or
  - (b)** is otherwise allowed to carry out those activities in accordance with the relevant national legal framework.
- [ii]** Any area of activity of an outsourcing Licence Holder other than those identified in above may be outsourced provided that such outsourcing does not impair:
- (a)** the orderliness of the conduct of the outsourcing Licence Holder's business or of the investment services provided;
  - (b)** the senior management's ability to manage and monitor the Licence Holder's business and its licensed activities;
  - (c)** the ability of other internal governance bodies, such as the board of directors or the audit committee, to fulfil their oversight tasks in relation to the senior management; and
  - (d)** the supervision of the outsourcing Licence Holder.
- [iii]** An outsourcing Licence Holder is recommended to take particular care when outsourcing material activities. SLC 4.04 requires Licence Holders to make available all information necessary to enable MFSA to supervise the compliance of the performance of the outsourced activities with the requirements of the Investment Services Rules. In this regard, the outsourcing Licence Holder should adequately inform MFSA about its outsourcing of material activities.
- [iv]** The senior managers of the outsourcing Licence Holder shall be fully responsible to the MFSA for any outsourced activity. These managers are therefore advised to take suitable measures to ensure that the outsourced activities continue to meet the performance and quality standards that would apply if their own institution were to perform the relevant activities in-house.
- [v]** An outsourcing Licence Holder should adequately inform MFSA on any material activity to be outsourced. Such information should be made available in a timely manner in order for the MFSA to evaluate the proposal or to allow such Licence Holder to consider whether the proposal raises prudential concerns and to take

appropriate action if required.

- [vi] Outsourcing Licence Holders should be aware that for the outsourcing of material activities the MFSA may impose specific conditions. In doing so, MFSA will consider factors such as the size of the Licence Holder, the nature of the outsourced activity, the characteristics and market position of the service provider, the duration of the contract and the potential of the outsourcing to generate conflicts of interest.
- [vii] An outsourcing Licence Holder should inform MFSA of any material development affecting the service provider and its ability to fulfil its obligations to its customers.
- [viii] Subject to the principles that apply also to cross-border outsourcing expressed under 4[B.1] [ii] above, no special conditions are applicable in relation to the geographical location of an outsourcing service provider. However, due to possible data protection risks and risks to effective supervision by the MFSA, institutions are recommended to take special care when entering into and managing outsourcing agreements that are undertaken outside the EU and the EEA.

#### Intra-Group Outsourcing

- [ix] Intra-group outsourcing and outsourcing according to point 4[B.1] [i] (a) above, can be material. Outsourcing Licence Holders should be aware that MFSA may take specific circumstances into consideration, such as the extent to which the outsourcing Licence Holder controls the service provider or has the ability to influence its actions, and the extent to which the service provider is included in the consolidated supervision of the group, when assessing the risks associated with an intra-group outsourcing arrangement and the treatment to apply to such arrangements.
- [x] When assessing, monitoring and controlling outsourcing arrangements in terms of this Guidance Note, in particular intra-group outsourcing arrangements, MFSA and the outsourcing Licence Holder should take into account the principle of proportionality.

## **4 [B.2]** *Outsourcing of Non-Material Activities*

- [i]** There should be no restrictions on the outsourcing of non-material activities of an outsourcing Licence Holder.
- [ii]** In such cases the outsourcing Licence Holder does not need to adequately inform the MFSA. Nevertheless, outsourcing Licence Holders should adequately manage the risks relating to such outsourcing arrangements at all times. In line with SLC 4.04, the senior management of the outsourcing Licence Holder should be fully responsible for any outsourced activity.
- [iii]** Areas which could be regarded as non-material are those not falling within the definition of “material activities” as defined above and may include:
  - (a)** areas which do not potentially constitute relevant risks and which, if outsourced, would not compromise the provisions set forth in **4 [B.1] [ii]** above; and
  - (b)** purely advisory services used by the Licence Holder. For example, this applies to legal and tax consulting, even where this is not limited to individual aspects or projects.

**4 [C] Outsourcing Licence Holder's Policies and Conduct of Business**

- [i]** An outsourcing Licence Holder should conduct its business in a controlled and sound manner at all times. Moreover, the outsourcing Licence Holder should preferably have a policy on its approach to outsourcing, including contingency plans and exit strategies as well as a general policy that covers all aspects of outsourcing, including non-material outsourcing, whether the outsourcing takes place within a corporate group or not.
- [ii]** When drawing up such policy the outsourcing Licence Holder should recognise that no form of outsourcing is risk free. The policy should recognise that the management of non-material and intra-group outsourcing should be proportionate to the risks presented by these arrangements.
- [iii]** The policy should explicitly consider the potential effects of outsourcing on certain significant functions (e.g. the internal audit function and the compliance function) when conducting the risk analysis prior to outsourcing.
- [iv]** The policy should ensure that the outsourcing service provider's financial performance and essential changes in the service provider's organisation structure and ownership structure are appropriately monitored and assessed by the outsourcing Licence Holder's management so that any necessary corrective measures can be taken promptly.
- [v]** The outsourcing Licence Holder should specify the internal units or individuals that are responsible for monitoring and managing each outsourcing arrangement.
- [vi]** The policy should consider the main phases that make up the life cycle of a Licence Holder's outsourcing arrangements:
  - (a)** the decision to outsource or change an existing outsourcing arrangement (the decision making phase);
  - (b)** due diligence checks on the outsourcing service provider;
  - (c)** drafting a written outsourcing contract and service level agreement (the pre-contractual drafting phase);
  - (d)** the implementation, monitoring, and management of an outsourcing arrangement (the contractual phase). This may include also the following-up of changes affecting the outsourcing service provider (e.g. major change in ownership, strategies, profitability of operations);
  - (e)** dealing with the expected or unexpected termination of a contract and other service interruptions (the post-contractual phase). In particular, the



outsourcing Licence Holder should plan and implement arrangements to maintain the continuity of its business in the event that the provision of services by an outsourcing service provider fails or deteriorates to an unacceptable degree, or the firm experiences other changes. This policy should include contingency planning and a clearly defined exit strategy.

**4 [D] Management of Risks Associated With Outsourcing**

- [i]** An outsourcing Licence Holder is advised to manage the risks associated with its outsourcing arrangements. The management of outsourcing arrangements should be proportionate to the risks presented by these arrangements.
- [ii]** The outsourcing Licence Holder should carry out an on-going assessment of the operational risks and the concentration risk associated with all its outsourcing arrangements. An outsourcing Licence Holder should inform MFSA of any material development.
- [iii]** The management of outsourcing risks should always be commensurate with the risks inherent in the specific outsourcing arrangement.

**4 [E] The Outsourcing Contract**

- [i]** Any outsourcing arrangement should be based on a formal, clear, written contract (SLC 4.06). This contract should be comprehensive and in particular, it should oblige the outsourcing service provider to protect confidential information (SLC 4.05(j)).
- [ii]** It is recommended that an outsourcing Licence Holder makes sure that the written contract takes account of the following:
- (a)** The operational activity that is to be outsourced is clearly defined;
  - (b)** The precise requirements concerning the performance of the service are specified and documented, taking account of the objective of the outsourcing solution. The outsourcing service provider's ability to meet performance requirements in both quantitative and qualitative terms should be assessable in advance;
  - (c)** The respective rights and obligations of the outsourcing Licence Holder and the outsourcing service provider are precisely defined and specified. This serves to ensure compliance with laws and supervisory regulations and guidelines for the duration of the outsourcing arrangement;
  - (d)** In order to underpin an effective policy for managing and monitoring the outsourced activities, the contract includes a termination and exit management clause, where proportionate and if deemed necessary, which allows the activities being provided by the outsourcing service provider to be transferred to another outsourcing service provider or to be reincorporated into the outsourcing Licence Holder at the request of the outsourcing Licence Holder;
  - (e)** The contract covers the protection of confidential information, banking secrecy and any other specific provisions relating to handling confidential information. Whenever information is subject to confidentiality rules at the level of the outsourcing institution at least the same level of confidentiality should be ensured by the service provider;
  - (f)** The contract ensures that the outsourcing service provider's performance is continuously monitored and assessed so that any necessary corrective measures can be taken promptly;
  - (g)** The contract includes an obligation on the outsourcing service provider to allow the outsourcing Licence Holder's compliance and internal audit departments complete access to its data and its external auditors full and

unrestricted rights of inspection and auditing of that data;

- (h) The contract includes an obligation on the outsourcing service provider to allow direct access by the MFSA to relevant data and its premises as required;
  - (i) The contract includes an obligation on the outsourcing service provider to immediately inform the outsourcing Licence Holder, or the MFSA directly, of any material changes in circumstances which could have a material impact on the continuing provision of services. This may require obtaining consents from affected parties such as the parent company and relevant home supervisory authority;
  - (j) The contract contains provisions allowing the outsourcing Licence Holder to cancel the contract by contractual notice of dismissal or extraordinary notice of cancellation.
- [iii]** When drafting the outsourcing contract the outsourcing Licence Holder is advised to bear in mind that the level of monitoring, assessment, inspection and auditing required by the contract should be proportionate to the risks involved and the size and complexity of the outsourced activity.

**4 [F] Responsibilities of the Outsourcing Licence Holder and Outsourcing Service Provider.**

- [i]** In managing its relationship with an outsourcing service provider, an outsourcing Licence Holder should ensure that a written agreement on the responsibilities of both parties and a quality description is put in place.
- [ii]** A written agreement should normally contain a mixture of quantitative and qualitative performance targets, to enable an outsourcing Licence Holder to assess the adequacy of service provision.
- [iii]** An outsourcing Licence Holder should also consider the need to evaluate the performance of its outsourcing service provider using mechanisms such as service delivery reports, self-certification or independent review by the outsourcing Licence Holder's, or the outsourcing service provider's, internal and/or external auditors.
- [iv]** An outsourcing Licence Holder should be prepared to take remedial action if the outsourcing service provider's performance is inadequate.

**4 [G] Chain Outsourcing**

- [i]** The outsourcing Licence Holder should take account of the risks associated with “chain” outsourcing.
- [ii]** The outsourcing Licence Holder should agree to chain outsourcing only if the sub-contractor will also fully comply with the obligations existing between the outsourcing Licence Holder and the outsourcing service provider, including obligations incurred in favour of the MFSA.
- [iii]** The outsourcing Licence Holder should take appropriate steps to address the risk of any weakness or failure in the provision of the sub-contracted activities having a significant effect on the outsourcing service provider's ability to meet its responsibilities under the outsourcing agreement.
- [iv]** The sub-outsourcing of outsourced activities and functions to third parties (sub-contractors) should be treated by the outsourcing Licence Holder like a primary outsourcing measure. Compliance with these conditions should be ensured contractually, for example by a clause in the outsourcing contract requiring the prior consent of the outsourcing Licence Holder to the possibility and the modalities of sub-outsourcing.
- [v]** The outsourcing Licence Holder should ensure that the outsourcing service provider agrees that the contractual terms agreed with the sub-contractor will always conform, or at least not be contradictory, to the provisions of the agreement with the outsourcing Licence Holder.

Licence Holders may outsource material activities to service providers located in Recognised Jurisdictions. For the purpose of this Guidance Note, Recognised Jurisdictions include EU and EEA Members, and signatories to a Multilateral MoU or Bilateral MoU with the MFSA covering the relevant sector of financial services

## GUIDANCE NOTES

### TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

#### GUIDANCE NOTE NO. 5

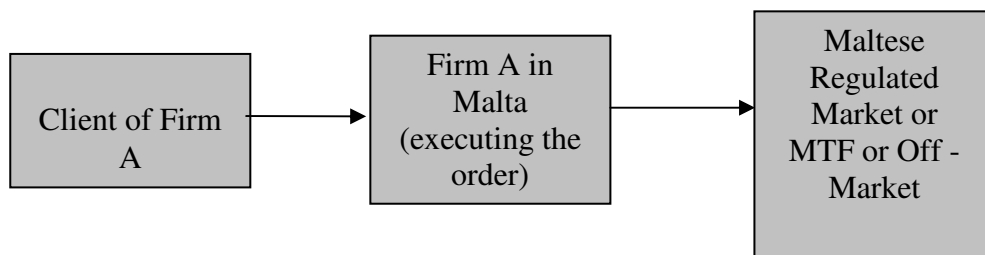
#### Transaction Reporting – [SLC 8.01 – 8.05]

##### 5 [A] Execution of a Transaction and Reportable Transactions

- [i] SLC 8.02 provides that a Licence Holder or the Branch of an Investment Firm passporting into Malta which executes a transaction in any Reportable Instrument must report the details of such transaction to the MFSA.
- [ii] The same SLC provides for a number of exemptions from this requirement. In order to assist licence holders in further understanding the mechanics of this requirement and the manner in which the exemptions apply, the following scenarios<sup>4</sup> have been prepared:

##### Scenario No 1

The Licence Holder or the Branch of an Investment Firm passporting into Malta executes an order on behalf of clients or on own account in instruments traded on a Maltese Regulated Market, irrespective of whether such trades were transacted on the said Maltese Regulated Market or an MTF or off-market.



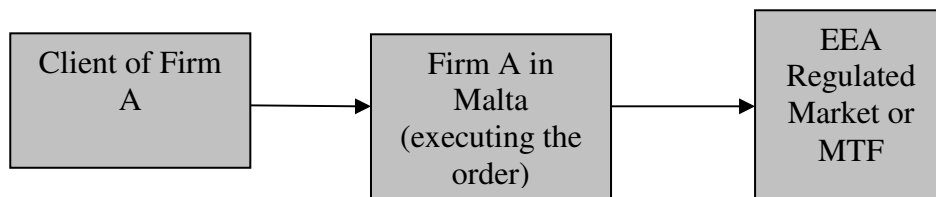
Exemption (c) of SLC 8.02 applies.

<sup>4</sup> All 4 scenarios assume that the Licence Holder is executing a deal on behalf of a client through a regulated market or outside a regulated market but not dealing on own account. Please note that the same reporting requirement applies if the Licence Holder is dealing on own account.

The Licence Holder or the Branch of an Investment Firm passporting into Malta does not need to report directly to the MFSA as the Maltese Regulated Market or MTF is required in terms of Law to report all applicable transactions (whether on or off-market) itself.

## Scenario No 2

The Licence Holder or the Branch of an Investment Firm passporting into Malta executes an order on behalf of clients or on own account on a EEA regulated market or on an EEA MTF [i.e. other than a Maltese Regulated Market or an MTF] in instruments traded on an EEA regulated market (other than a Maltese regulated market), meaning that the Licence Holder or the Branch of an Investment Firm passporting into Malta, has been given access to the trading platform of the said EEA Regulated Market or an MTF in its offices in Malta, is a member of the said EEA Regulated Market or MTF and has dealt directly on the said EEA Regulated Market or MTF on behalf of a client, in the clients own name or as trustee/nominee.



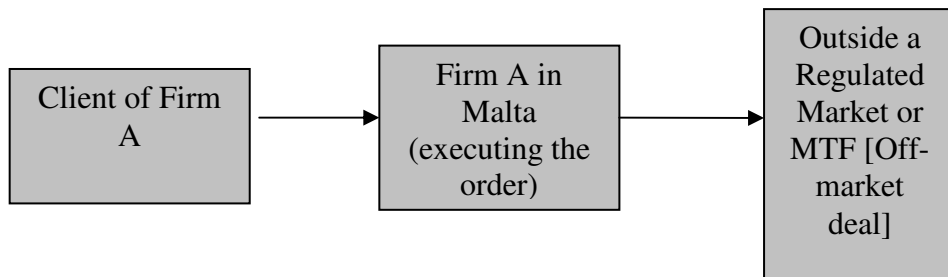
The Licence Holder or the Branch of an Investment Firm passporting into Malta is required to report such transactions to the MFSA.

However, in the case of branches of Licence Holders operating in other EEA Member States exemption (d) of SLC 8.02 applies i.e. a Branch of a Licence Holder in Italy which is a member of the Borsa Italiana and which executes an order on behalf of a client on the Borsa Italiana must report the transaction **ONLY** to the Host Competent Authority which in this example is the CONSOB.

## Scenario No 3

The Licence Holder or the Branch of an Investment Firm passporting into Malta executes an order on behalf of clients or on own account outside a Regulated Market or an MTF in instruments traded on an EEA Regulated Market (other than a Maltese regulated market), meaning that the Licence Holder or the Branch of an Investment Firm passporting into Malta finds a buyer or a seller for his client, off-market (outside a regulated market or an MTF) and executes the trade on behalf of the client whether in his own name or under the licence holder's nominee/trustee account.



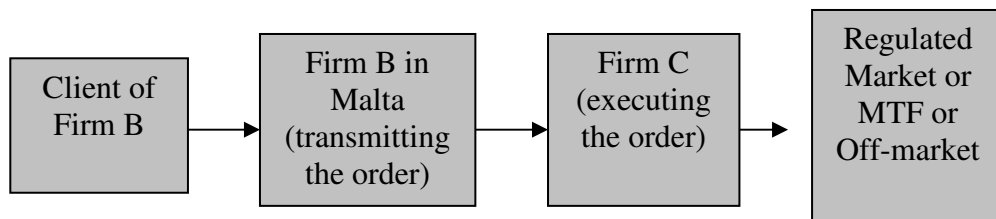


The Licence Holder or the Branch of an Investment Firm passporting into Malta is required to report such transactions to the MFSA.

However, in the case of branches of Licence Holders operating in other EEA Member States exemption (d) of SLC 8.02 applies i.e. a Branch of a Licence Holder in Italy which executes an order on behalf of a client off-market must report the transaction **ONLY** to the Host Competent Authority which in this example is the CONSOB.

#### **Scenario No 4**

Receiving and transmitting client's orders to deal in an instrument traded on a Regulated Market meaning that the Licence Holder or the Branch of an Investment Firm passporting into Malta merely transmits the order of the client to another Licence Holder or an investment firm which executes the transaction in the clients own name or in the name of Licence Holder's nominee or trustee account.



The Licence Holder transmitting the order is not required to report to the MFSA as it is merely transmitting this order to another Licence Holder or investment firm.

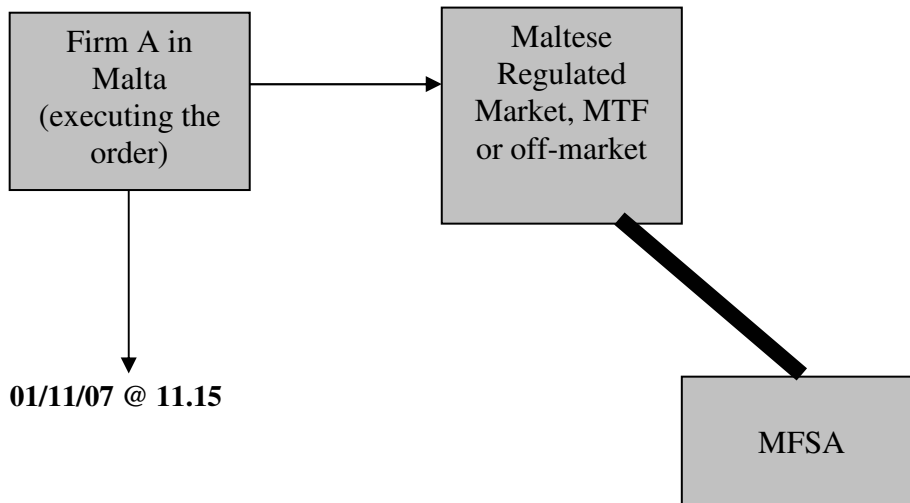
The investment firm which ultimately executes the transaction will be required to report this trade. Where such investment firm is a Licence Holder, such reporting shall be made to the MFSA.

**5 [B] When should Transactions be Reported?**

**Standard Licence Condition 8.03** stipulates that transactions should be reported to the Authority as soon as possible and in any case by **not later than the close of the following working day from when the transaction was executed**. Should this not be possible, the Licence Holder must inform the MFSA immediately of the reasons why transactions cannot be reported within the stipulated timeframe. Such notification should preferably be made in writing.

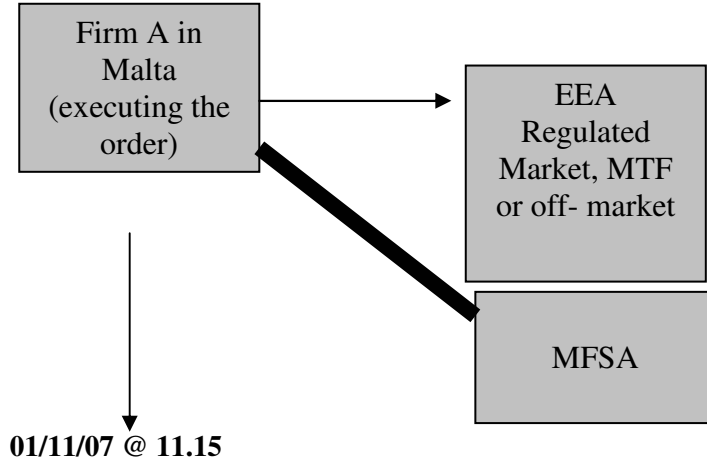
Please note the following examples:

**Example 1:**



**Regulated Market must report the transactions to the MFSA on behalf of investment Firm A by not later than 02/11/07@ 17.00.**

**Example 2:**



**Firm A must report the transaction to the MFSA by not later than 2/11/07@ 17.00**

**5 [C] Commission Regulation (EC) No. 1287 / 2006 [‘Implementing Regulation’]**

- [i]** While **Article 25** of the MiFID establishes the general framework for transaction reporting requirements in respect of transactions in financial instruments, the implementing regulation issued on 2<sup>nd</sup> September 2006, details more specifically the requirements regulating transaction reporting so as to ensure equivalent market conditions and the smooth operation of securities markets through the European Community and to facilitate the effective integration of these markets.
  
- [ii]** The regime established by MiFID governing transaction reporting requirements aims to ensure that relevant competent authorities are properly informed about transactions in which they have a supervisory interest. For this purpose it was necessary to ensure that a single data set is collected from all investment firms with a minimum of variation between Member States, so as to minimise the extent to which businesses operating across borders are subject to different reporting obligations. This single data set is spelt out in **Annex 1 Table 1 [‘Annex’]** of the implementing regulation and explained further in **5 [D.1]** below.
  
- [iii]** For further information in respect of regulations governing transaction reporting, reference should be made to **Chapter III** of the implementing regulation **Articles 9 to 16**.

## **5 [D] Compilation of a Transaction Report**

### **5 [D.1] Content of a Transaction Report**

**[i]** The **Annex** of the implementing regulation stipulates the **minimum** amount of information which the Licence Holder or the Branch of an Investment Firm passporting into Malta are required to submit to a Competent Authority when reporting transactions. To the effect that transactions reported to one Competent Authority may, under particular circumstances, necessitate on forwarding to other Competent Authorities within the E.U., the Committee of European Securities Regulators has guided E.U. Competent Authorities in setting industry standards for the collection of information contained in transaction reports.

**[ii]** While the **Annex** stipulates the minimum information to be reported to the MFSA, the Licence Holder or the Branch of an Investment Firm passporting into Malta must note that the MFSA has implemented the provisions of **Article 13 (3)** and **13 (4)** of the implementing regulation, which give power to the Authority to require additional information to be reported over and above that stipulated by the **Annex**. However particular instrument reference data (that is information which is specific to the instrument rather than the particular transaction being reported) listed in the **Annex** will not be requested in transaction reporting. Consequently, a Licence Holder or the Branch of an Investment Firm passporting into Malta should note the content of Appendix 8 to the Investment Services Rules which deals with transaction reporting.

**[iii]** A Licence Holder should note that to be able to use the transaction reporting system, programmed by the MFSA to enable such reporting parties to fulfil their transaction reporting obligations, it must be in possession of a non-SWIFT Bank Identifier Code. Such code may be obtained free of charge through the appropriate numbering agency- the Society for Worldwide Interbank Financial Telecommunication ['SWIFT']. A Licence Holder should contact SWIFT via their official website using the following link:

[https://www2.swift.com/formz/public/index.cfm?form\\_config=public\\_bic1request&form\\_title=%20Request%20an%208%20characters%20BIC%20for%20a%20non%20SWIFT%20User&form\\_roadmap=%20http://www.swift.com/index.cfm?item\\_id=43685](https://www2.swift.com/formz/public/index.cfm?form_config=public_bic1request&form_title=%20Request%20an%208%20characters%20BIC%20for%20a%20non%20SWIFT%20User&form_roadmap=%20http://www.swift.com/index.cfm?item_id=43685)

- 5 [D.2]** Reporting parties should aim at providing the MFSA with the information noted in the Appendix 8 of the Investment Services Rules with the utmost accuracy in order to avoid any unnecessary delays in the MFSA's ability to process received transactions. In addition, reporting parties should note that all such information is mandatory and should be the content of **every individual** submitted transaction report.

**GUIDANCE NOTES**

**TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

**APPENDIX I**

**COMPLIANCE FUNCTION – REQUEST FOR EXEMPTION FROM SLC 1.22 (C) & (D)**

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<b>Date:</b>	
<b>Licence Holder Name:</b>	
<p>SLCs 1.20 to 1.22 stipulate requirements dealing with the compliance function which a Licence Holder is required to satisfy. <i>Inter alia</i> SLC 1.22 requires a Licence Holder to ensure that:</p> <ul style="list-style-type: none"><li>◆ the relevant persons involved in the compliance function must not be involved in the performance of services or activities which they monitor; and</li><li>◆ the method of determining the remuneration of the relevant persons involved in the compliance function must not compromise the objectivity or must not be likely to do so.</li></ul>	
<p>Explain below (supplemented by attachments as necessary), why in view of the nature, scale and complexity of the Licence Holder's business, and the nature and the range of its investment services and activities, the Licence Holder considers that the above mentioned requirement is not proportionate, and on what basis the Licence Holder considers that its compliance function continues to be effective nonetheless.</p>	

**GUIDANCE NOTES**

**TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

**APPENDIX II  
RISK MANAGEMENT FUNCTION – REQUEST FOR EXEMPTION FROM SLC 1.24**

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<b>Date:</b>	
<b>Licence Holder Name:</b>	
<p>SLCs 1.23 to 1.24 stipulate requirements dealing with risk management which a Licence Holder is required to satisfy. <i>Inter alia</i> SLC 1.24 requires a Licence Holder to establish and maintain a risk management function that operates independently and carries out the following tasks:</p> <p>[a] implementation of the risk management policy and procedures; and</p> <p>[b] provision of reports and advice to senior management on a frequent basis [at least annually].</p>	
<p>Explain below (supplemented by attachments as necessary) why the Licence Holder considers the establishment and maintenance of an ‘independent’ risk management function is not appropriate and proportionate in view of the nature, scale and complexity of its business, and the nature and the range of investment services and activities, undertaken in the course of that business.</p>	



**GUIDANCE NOTES**

**TO THE INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

**APPENDIX III**

**INTERNAL AUDIT – NOTIFICATION IN TERMS OF SLC 1.28**

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<b>Date:</b>	
<b>Licence Holder Name:</b>	
<p>SLC 1.28 provides that depending on the nature, scale and complexity of the licence holder’s business and the nature and range of investment services and activities undertaken in the course of its business, the Licence Holder shall establish an internal audit function.</p>	
<p>Explain below (supplemented by attachments as necessary), why the Licence Holder considers that in view of the nature of its business and its scale, it is not necessary/appropriate and/or feasible for it to establish an internal audit function.</p>	

## APPENDIX IV

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### SPECIMEN CONFIDENTIAL CLIENT FACT-FIND FOR THE SUITABILITY TEST

**A Client Suitability Test is ONLY required when:**

[i] the client is being offered the service of investment advice; or

[ii] the client is being offered portfolio management services;

Client Name and Surname	
Client Contact Number	
Client Classification	<input type="checkbox"/> Retail <input type="checkbox"/> Professional
Service Rendered	<input type="checkbox"/> Investment Advice <input type="checkbox"/> Portfolio Management
Client Reference Number	
<i>Date</i>	
<i>Prepared By</i>	
<i>Special Instructions</i>	

<b>Personal Details</b>				
	<b>Self</b>		<b>Partner/Spouse</b>	
Mr/Mrs/Miss/Ms or Title				
Surname				
First Name				
Date of Birth				
Marital Status				
Residential Address				
Is this your correspondence address?	<input type="checkbox"/> Yes	<input type="checkbox"/> No	<input type="checkbox"/> Yes	<input type="checkbox"/> No
Correspondence Address				
Preferred method of contact	Mail	Telephone	Fax	Mail Telephone Fax
Numbers : Work				
: Home				
: Fax				
: Mobile Phone				
: E-mail Address				

<b>Children and Dependants</b>				
<b>Name</b>	<b>Relationship</b>	<b>Age</b>	<b>Dependant</b>	
			Yes	No
			Yes	No
			Yes	No
			Yes	No
			Yes	No

<b>Residence</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
What is your nationality?		
What is your country of residence for tax purposes?		
What is your country of domicile?		
Other comments		

<b>Occupation, Income and Knowledge in Investment Field</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
Level of Education		
Employment Status (Permanent/Temporary/Self Employed/ Retired):		
Occupation:		
Employer:		
Net Annual Income [including income from main occupation, part- time work (if applicable) and/ or interest, dividends etc.]:		
With which investment service/s is the client familiar with?		
With which financial instrument/s is the client familiar with?		

<b>Summary of Assets</b>				
<i>Please indicate whether the assets are owned by <u>Self</u> [S], <u>Jointly</u> [J] or by your <u>Partner</u> [P]</i>				
	<b>Self</b>		<b>Partner/Spouse</b>	
	<b>Volume and/or Amount of Investment</b>	<b>Frequency of Investment</b>	<b>Volume and/or Amount of Investment</b>	<b>Frequency of Investment</b>
Home		N/A		N/A
Other Property		N/A		N/A
Valuables		N/A		N/A
Financial Instruments (e.g. Government Bonds/				

### Summary of Assets

*Please indicate whether the assets are owned by Self [S], Jointly [J] or by your Partner [P]*

	Self		Partner/Spouse	
Corporate Bonds/ Equities/ CIs/ Complex instruments etc.)				
Life Assurance Policies		N/A		N/A
Bank Deposits		N/A		N/A
Other Assets		N/A		N/A
<b>Total Assets</b>				

### Summary of Liabilities

*Please indicate whether the liabilities are owed by Self [S], Jointly [J] or by your Partner [P]*

	Self		Partner/Spouse	
Home Loan Monthly Payment Term Remaining:				
Car Loan Monthly Payment Term Remaining:				
Other Loans Monthly Payment Term Remaining:				
Other Liabilities Monthly Payment Term Remaining:				
<b>Total Liabilities</b>				

<b>Life Assurance</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
Owner:		
Insurance Company:		
Policy type:		
Start Date:		
Maturity Date:		

<b>Wills</b>				
	<b>Self</b>		<b>Partner/Spouse</b>	
	<b>Yes</b>	<b>No</b>	<b>Yes</b>	<b>No</b>
Have you made a will?				
Does the will need to be updated?				
Name and address of executors :				

<b>Investment Objectives, Planning and Risk Profile</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
How much capital does the client wish to invest?		
Over what period does the client wish to invest this capital?		
Does the client intend to invest on a frequent basis? What frequency?		
What is the purpose of the investment (i.e. maximise income, retirement planning, capital growth, tax purposes etc...)?		
For how long does the investor wish to hold the investment?		
What is the investor's attitude towards risk?		
<b>Low ? High Risk?</b>	<b>Medium?</b>	

<b>Investment Objectives, Planning and Risk Profile</b>				
	<b>Self</b>		<b>Partner/Spouse</b>	
How much money would you need as an emergency fund?				
Have you any plans that require large sums of money in the future?	<b>Yes</b>	<b>No</b>	<b>Yes</b>	<b>No</b>
If Yes: Purpose				
Amount required				
Date amount required				

**Client Confirmation**

I/We confirm that I/We have read this form, and that the information provided by me/ us is factual, correct and true.

I/We confirm that I/We do/do not\* require a copy of this document. \*delete as appropriate

I/We understand that the information provided here may be used for the purpose of making investment recommendations in the future. I/We agree that you may up-date or supplement the information that you hold about me/us (Personal Data) on the ..... customer systems with information contained in this form and use it in line with my/our instructions concerning the use of Personal Data within the .....

I/We have read (or had explained to me) and understand (*insert the titles of any relevant documentation provided to the Client*).

I/We understand that I/We should consult my/our legal tax advisors regarding the tax implications of contributing to or receiving benefits from any products recommended under the laws of my/our country of residence, citizenship or domicile.

I/We confirm that I/We have had the medium/long term nature of investments explained to me/us.

I/We confirm that I/We have been informed that the value of investments and the income from them can fluctuate and that I/We may not get back the amount invested. I/We appreciate that this may mean selling an investment in an inopportune moment which may result in a loss.

I/We confirm that I am/we are NOT DEALING on the account of any other person – physically, legally or otherwise constituted. I/We do hereby declare that I am/We are dealing in my/our own name/s.

Client		Date	/	/
Partner/Spouse		Date	/	/
Joint/Party		Date	/	/
Joint/Party		Date	/	/
Financial Adviser		Date	/	/



### **Verification of Identity**

*Where there is a joint investment, the identity of all parties must be verified*

<b>Self</b>		<b>Surname</b>	<b>First Name/s</b>	<b>Document No.</b>
Document Type				
<b>Partner/Spouse</b>		<b>Surname</b>	<b>First Name/s</b>	<b>Document No.</b>
Document Type				
<b>Joint Party</b>		<b>Surname</b>	<b>First Name/s</b>	<b>Document No.</b>
Document Type				

Verification of identity is required for the satisfaction of Article 5 of Legal Notice 199 of 2003 issued in terms of the Prevention of Money Laundering and Funding of Terrorism Act, 1994.

### **Source of Funds**

Name of Bank	
Sort Code	
Account Name	
Account Number	
Method of Payment	
Amount of Payment	

### **Anti- Money Laundering Customer Acceptance Policy**

	<b>Yes</b>	<b>No</b>
Is the customer a Political Exposed Person meaning a person who has been entrusted with prominent public functions? [This shall include their immediate family members or persons known to be close associates of such persons, but shall not include middle ranking or more junior officials]		
Does the customer pose a higher than average risk for money laundering or funding of terrorism?	[Provide customer description]	

### **Anti- Money Laundering Customer Acceptance Policy**

	<b>Yes</b>	<b>No</b>
Does the client's background, country of origin, business activities, linked account or activities, and/or high profile position pose a higher risk that the client is involved in money laundering and/or funding of terrorism?		
Does the client require an enhanced customer due diligence process?	[Provide details]	

### **Assessment of Suitability**

	<b>Yes</b>	<b>No</b>
Is the service provided and transaction to be recommended in line with the investment objectives of the client?		
Is the service provided and transaction to be recommended financially bearable for the client?		
Is the client familiar with the type of service, transaction and financial instrument being offered?		
Has the client provided information with respect to his financial situation (i.e. his assets and liabilities)?		[Inform the client that the lack of provision of this information does not allow the Licence Holder to recommend an investment service or financial instrument]
Has the client provided information with respect to his investment objectives, planning and risk attitude to enable the Licence Holder to determine the client's knowledge and experience in the investment field?		[Inform the client that the lack of provision of this information does not allow the Licence Holder to recommend an investment service or financial instrument]
Has the client provided information with respect to his occupation to enable the Licence Holder to determine the client's knowledge and experience in the investment field?		[Inform the client that the lack of provision of this information does not allow the Licence Holder to recommend an investment service or financial instrument]



**APPENDIX V**

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**SPECIMEN  
CONFIDENTIAL CLIENT FACT-FIND  
FOR THE  
APPROPRIATENESS TEST**

**A Client Appropriateness Test is ONLY required when:**

- [i] the client is not being offered the service of investment advice; and**
- [ii] the client is not being offered portfolio management services; and**
- [iii] any of the conditions referred to in Guidance Note 2 [B.2][iv] are not satisfied.**

Client Name and Surname	
Client Contact Number	
Client Classification	<input type="checkbox"/> <b>Retail</b> <input type="checkbox"/> <b>Professional</b>
Service Rendered	
Client Reference Number	
<i>Date</i>	
<i>Prepared By</i>	
<i>Special Instructions</i>	

<b>Personal Details</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
Mr/Mrs/Miss/Ms or Title		
Surname		
First Name		
Date of Birth		
Marital Status		
Residential Address		
Is this your correspondence address?	<input type="checkbox"/> Yes <input type="checkbox"/> No	<input type="checkbox"/> Yes <input type="checkbox"/> No
Correspondence Address		
Preferred method of contact	Mail      Telephone      Fax	Mail      Telephone      Fax
Numbers : Work		
: Home		
: Fax		
: Mobile Phone		
: E-mail Address		

<b>Children and Dependants</b>			
<b>Name</b>	<b>Relationship</b>	<b>Age</b>	<b>Dependant</b>
			Yes      No
			Yes      No
			Yes      No
			Yes      No
			Yes      No

<b>Residence</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
What is your nationality?		
What is your country of residence for tax purposes?		
What is your country of domicile?		
Other comments		

<b>Occupation and Knowledge in Investment Field</b>		
	<b>Self</b>	<b>Partner/Spouse</b>
Level of Education		
Employment Status (Permanent/Temporary/Self Employed/ Retired):		
Occupation:		
Employer:		
Net Annual Income [including income from main occupation, part- time work (if applicable) and/ or interest, dividends etc.]:		
With which investment service/s is the client familiar with?		
With which financial instrument/s is the client familiar with?		

<b>Summary of Assets</b>				
<i>Please indicate whether the assets are owned by <u>Self</u> [S], <u>Jointly</u> [J] or by your <u>Partner</u> [P]</i>				
	<b>Self</b>		<b>Partner/Spouse</b>	
	<b>Volume and/or Amount of Investment</b>	<b>Frequency of Investment</b>	<b>Volume and/or Amount of Investment</b>	<b>Frequency of Investment</b>
Home	N/A	N/A	N/A	N/A

## Summary of Assets

*Please indicate whether the assets are owned by Self [S], Jointly [J] or by your Partner [P]*

	Self		Partner/Spouse	
	Volume and/or Amount of Investment	Frequency of Investment	Volume and/or Amount of Investment	Frequency of Investment
Other Property	N/A	N/A	N/A	N/A
Valuables	N/A	N/A	N/A	N/A
Financial Instruments (e.g. Government Bonds/ Corporate Bonds/ Equities/ CISs/ Complex instruments etc.)				
Life Assurance Policies	N/A	N/A	N/A	N/A
Bank Deposits	N/A	N/A	N/A	N/A
Other Assets	N/A	N/A	N/A	N/A
<b>Total Assets</b>				

## Client Confirmation

I/We confirm that I/We have read this form, and that the information provided by me/ us is factual, correct and true.

I/We confirm that I/We do/do not\* require a copy of this document. \*delete as appropriate

I/We understand that the information provided here may be used for the purpose of making investment recommendations in the future. I/We agree that you may up-date or supplement the information that you hold about me/us (Personal Data) on the ..... customer systems with information contained in this form and use it in line with my/our instructions concerning the use of Personal Data within the .....

I/We have read (or had explained to me) and understand (*insert the titles of any relevant documentation provided to the Client*).

I/We understand that I/We should consult my/our legal tax advisors regarding the tax implications of contributing to or receiving benefits from any products recommended under the laws of my/our country of residence, citizenship or domicile.

I/We confirm that I/We have had the medium/long term nature of investments explained to me/us.

I/We confirm that I/We have been informed that the value of investments and the income from them can fluctuate and that I/We may not get back the amount invested. I/We appreciate that this may mean selling an investment in an inopportune moment which may result in a loss.

I/We confirm that I am/we are NOT DEALING on the account of any other person – physically, legally or otherwise constituted. I/We do hereby declare that I am/We are dealing in my/our own name/s.

I/We understand that I/we have not been provided with any investment recommendations/advice and have not given only portfolio management mandate to the company.

Client		Date	/ /
Partner/Spouse		Date	/ /
Joint/Party		Date	/ /
Joint/Party		Date	/ /
Financial Adviser		Date	/ /



### Verification of Identity

*Where there is a joint investment, the identity of all parties must be verified*

Self		Surname	First Name/s	Document No.
Document Type				
Partner/Spouse		Surname	First Name/s	Document No.
Document Type				
Joint Party		Surname	First Name/s	Document No.
Document Type				

Verification of identity is required for the satisfaction of Article 5 of Legal Notice 199 of 2003 issued in terms of the Prevention of Money Laundering and Funding of Terrorism Act, 1994.

### Source of Funds

Name of Bank	
Sort Code	
Account Name	
Account Number	
Method of Payment	
Amount of Payment	

### Anti- Money Laundering Customer Acceptance Policy

	Yes	No
Is the customer a Political Exposed Person meaning a person who has been entrusted with prominent public functions? [This shall include their immediate family members or persons known to be close associates of such persons, but shall not include middle ranking or more junior officials]		
Does the customer pose a higher than average risk for money laundering or funding of terrorism?	[Provide customer description]	

### **Anti- Money Laundering Customer Acceptance Policy**

	Yes	No
Does the client's background, country of origin, business activities, linked account or activities, and/or high profile position pose a higher risk that the client is involved in money laundering and/or funding of terrorism?		
Does the client require an enhanced customer due diligence process?	[Provide details]	

### **Assessment of Appropriateness**

	Yes	No
Does the client understand the risks involved with respect to the product or investment service offered [not applicable for professional clients]?		
Is the client engaging in a course of dealing of the same kind in which the Licence Holder has already conducted an appropriateness test?	[A new appropriateness test does not need to be conducted with respect to this client]	[A new appropriateness test needs to be conducted with respect to this client]
Is the client familiar with the type of service, transaction and financial instrument being offered?		
Has the client provided information with respect to his investment objectives, planning and risk attitude to enable the Licence Holder to determine the client's knowledge and experience in the investment field?		[Inform the client that the lack of provision of information does not allow the Licence Holder to effectively carry out its assessment]

<b>Assessment of Appropriateness</b>		
	<b>Yes</b>	<b>No</b>
Has the client provided information with respect to his occupation to enable the Licence Holder to determine the client's knowledge and experience in the investment field?		[Inform the client that the lack of provision of information does not allow the Licence Holder to effectively carry out its assessment]
Following the appropriateness test, does the Licence Holder believe that the requested product or service is appropriate for the client?		[Inform client that the requested product/ service is inappropriate]

*Licence Holder Employee:* \_\_\_\_\_

*Date:* \_\_\_\_\_

*Superior (if applicable):* \_\_\_\_\_

*Date:* \_\_\_\_\_