

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

BANKING UNIT

POLICY DOCUMENTS

*POLICY DOCUMENT ON THE REGULATORY PROVISIONS
FOR THE UNDERTAKING OF MONEY BROKING ACTIVITIES
BY INSTITUTIONS AUTHORISED UNDER THE
FINANCIAL INSTITUTIONS ACT 1994*

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INTRODUCTION

1. In terms of Section 3(1) of the Financial Institutions Act 1994 (the Act), an institution may be licensed to carry on the business of a Financial Institution through the undertaking of activities which are listed in the Schedule to Section 2 of the Act. One of the activities included in the list is money broking.

2. Section 3(2) of the Act states that:

“In the event of reasonable doubt as to whether an activity constitutes the business of a financial institution or whether the business of a financial institution is or is not being transacted in or from Malta by any person, the matter shall be conclusively determined by the Competent Authority.”

3. Section 13(1) of the Act states *inter alia* that:

“It shall be the duty of the Competent Authority ... to ensure that financial institutions carrying on business in Malta comply with the Act ... and with the conditions of their licenses ...”

4. In view of these statutory obligations and responsibilities, the Competent Authority¹, therefore, deems it appropriate to state its general views on the undertaking of money broking activities by institutions licensed under the Act. At the same time, while taking full cognizance of the contents of this policy document, licensed institutions are encouraged to seek any legal advice they consider appropriate to ensure statutory and regulatory compliance.

PURPOSE OF THIS POLICY DOCUMENT

5. This policy document is being issued to:

- a) foster understanding between licensed institutions and the Competent Authority in relation to what constitutes money broking activities;
- b) create awareness among licensed institutions undertaking, or desirous of undertaking money broking activities of the requisites which the Competent Authority considers appropriate for this activity;

¹ *In terms of Legal Notice No.324 of 2001 the Minister of Finance appointed the Malta Financial Services Centre, now known as the Malta Financial Services Authority by virtue of the coming into force of the Malta Financial Services Authority Act 2002 as the relative Competent Authority for the purposes of the Act.*

- c) specify the standards and controls which licensed institutions are expected to adopt when carrying out money broking activities;
- d) facilitate the monitoring by the Competent Authority of money broking activities carried out by financial institutions licensed accordingly through the attainment of objectives 'a' to 'c' above;
- e) allow the Competent Authority to put forward its views on the significant differences in the respective role and responsibilities of institutions licensed to carry out money broking activities and their counterparties.

THE CHARACTERISTICS OF MONEY BROKING

- 6. Money broking covers the activity of introducing counterparties utilising wholesale and retail financial products². This is an intermediary/agency/introducer function through which an institution undertaking money broking activities brings together principals who wish to deal at mutually agreed terms for the same financial products.
- 7. Financial products that are relevant to money broking activities may, amongst others, include wholesale local and foreign currency bank deposits, spot and forward foreign exchange, warrants, futures, options, convertibles (derivatives), lending related products and items such as guarantees and commitments as long as these are not held or acquired for investment purposes.
- 8. A licensed institution carrying out money broking transactions is entitled to receive brokerage or commission fees.
- 9. An institution carrying out money broking transactions acts as a focal point for incoming orders, monitors relevant product terms and conditions and keeps records of pending and unfulfilled transactions.
- 10. Institutions carrying out money broking activities must be specialized in their knowledge of relevant financial products and are expected to be fully conversant and aware of the sources of supply and demand, terms and conditions related to such products and relevant market information.
- 11. The persons employed with licensed institutions that deal in money broking activities must be fit and proper to conduct this activity. Such persons must have the requisite experience and competence and must also be conversant with the various financial products listed under Article 7 above.

ROLE OF INSTITUTIONS UNDERTAKING MONEY BROKING ACTIVITIES

- 12. In carrying out the main role as arranger of deals in the money broking activity, a licensed institution:

² *Products not regulated by the Investment Services Act 1994.*

- a) brings together counterparties on mutually acceptable terms to facilitate the conclusion of a transaction;
 - b) receives payment for its service in the form of brokerage or commission fees (except where a prior explicit agreement between the interested parties to a deal provides otherwise); and
 - c) is not permitted to act as principal³ except as may be allowed under circumstances described in Article 17 (d) in a deal or to act in any discretionary fund management capacity.⁴
13. The Competent Authority recognises that in providing a money broking service, a licensed institution may be asked to give advice or express opinions in relation to the relevant financial product and/or an eventual counterparty. In such instances confidential information about the market activities of individual customers cannot be revealed. However, there is no restriction on a licensed institution to pass or comment on general information that is in the public domain.
14. The Competent Authority does not expect a licensed institution to volunteer general information of the type referred to in Article 13 indiscriminately. When such information is sought or volunteered, a licensed institution is to exercise particular care. The reason for this is that the institution may not have sufficient information to be qualified to advise principals on specific counterparties.
15. When a licensed institution is acting as an agent for connected or other undertakings and is not dealing in the capacity of a money broker on a stand alone basis, the Competent Authority expects a licensed institution to:
- a) always make it absolutely clear to all concerned, the capacity in which the institution is acting;
 - b) declare at an early stage of negotiations the party for whom the licensed institution is acting. (It may be considered desirable to set out this relationship formally in writing for future reference);
 - c) ensure that all confirmations show clearly that a deal has been done on an agency basis; and

³ *A fundamental difference in the role of an institution acting as principal and an institution undertaking money broking activities is that principals 'deal for their own account' while money brokers are intermediaries. Principals are also responsible for assessing the creditworthiness of their counterparties, whether dealing directly or through money broking firms.*

⁴ *If the relationship between a licensed institution offering an advisory and/or management service, and its clients on financial products constitutes investment business within the terms of the Investment Services Act 1994 then such services are governed by this Act.*

- d) make it clear at the outset to potential counterparties that it is acting as an agent of an unregulated principal if it is the case, and must include a qualification as such in its confirmation.

RISKS AND RESPONSIBILITIES OF MONEY BROKING INSTITUTIONS

- 16. The Competent Authority would only authorise an institution to carry out money broking activities if, besides other licensing criteria, the institution has a sufficient capital base. An adequate capital base would allow the institution to meet its running expenses and also to continue operating for a reasonable time in the event that business volume drops significantly.
- 17. Although, generally speaking, the Competent Authority considers a licensed institution carrying out money broking activities as not being subject to the risks characterising banking and/or financial institutions in general, it may still be exposed to residual risks of potential trading loss arising from:
 - a) operating expenses where turnover (therefore income) falls sharply;
 - b) compensation for errors committed and resulting in customers suffering losses;
 - c) the loss of income when customers fail to pay commission/brokerage fees; and
 - d) the open position in which money brokers may technically need to take in certain transactions when acting on a *matched principal basis*.⁵
- 18. The Competent Authority expects a licensed institution carrying out money broking to ensure that:
 - a) employees who commit the institution to a transaction have the necessary authority to do so, and, moreover, they must ensure that at no time should they mislead counterparties about the institution's limited role;
 - b) employees are adequately trained in the practices of the markets in which they transact, and are aware of their own and the institution's responsibilities;
 - c) employees understand the products in which they are appointed to deal;

⁵ *Exceptional instances may arise beyond those described in Article 12(c), when both counterparties may not wish to reveal their identity. In such cases, the institution, in acting as an intermediary, may put through the trade by taking position as a principal and entering into two back-to-back transactions with the two counterparties. It is therefore technically possible that institutions may take open positions for a very short time. Such transactions must, however, all be made on a matched principal basis.*

- d) material facts to transactions are disclosed to interested parties prior to a deal being effected, except where such disclosure would constitute confidential information about the activities of another form or counterparty;
 - e) employees comply with any other regulatory requirements that may be applicable or relevant to the institution's activities.
19. When establishing a relationship with a new counterparty, a licensed institution must take the necessary steps to make such parties aware of the precise nature of their liability for the transactions to be conducted and also of the contractual agreements before transactions are effected. All licensed institutions must know their counterparties and when they are acting as *matched principals*, this is essential.
 20. In view of the nature of money broking, institutions are advised to seek proper legal advice before as well as during the drawing up of contractual agreements.
 21. The Competent Authority refers to the possibility of potential conflicts of interest when a licensed institution is transacting both as an agent as well as a money broker. The Competent Authority expects licensed institutions to identify any potential or actual conflicts of interest that may arise when undertaking transactions, and take measures either to eliminate or to control them, in order to ensure fair treatment to counterparties.
 22. In the identification of their counterparties, licensed institutions must take all the necessary precautions to prevent their transactions in the markets being used to facilitate money laundering offences. Licensed institutions are expected to be familiar and implement the provisions of the *Prevention of Money Laundering Act 1994* and related Regulations.

PRINCIPLES AND PROCEDURES OF MONEY BROKING TRANSACTIONS

23. The Competent Authority expects a licensed institution to clearly state any qualifying conditions to which the transaction will be subject (e.g. finding a counterparty for matching deals). This must be done during the preliminary negotiations of the transaction and prior to its execution.
24. A licensed institution has a duty to clarify whether the prices being quoted are firm or merely indicative.
25. When undertaking money broking activities a licensed institution must not divulge the names of the principals prematurely, and certainly not until satisfied that both sides display a serious intention to transact.
26. The Competent Authority deems that expeditious processing, recording and checking of transactions are important to minimize the possibility of errors.

27. In all relevant transactions confirmations are to be checked carefully and promptly, even when oral checks have been undertaken. The issue and checking of confirmations is a back-office responsibility that must be carried out independently from those who initiate deals. The confirmations must, amongst others, include:
- a) the transaction date;
 - b) the name of the other counterparty; and
 - c) all details of any related transactions, including, where appropriate, the commission charged by the money broking institution.
28. The Competent Authority strongly recommends the use of standard settlement instructions since this procedure significantly reduces both the incidence and size of differences arising from the mistaken settlement of funds.
29. The Competent Authority expects commission/brokerage fees to be freely negotiable between the money broking institution and the principal and also that such fees would be settled without undue delays.
30. Institutions carrying out money broking activities must act professionally at all times and use clear and unambiguous terminology. This is even more important when dealing with *non-core principals*⁶, whose staff may be less experienced in dealing in the markets.
31. Any deposits accepted on a fiduciary or matched principal basis by a licensed institution acting as a money broker are to be placed with an appositely licensed institution under the Banking Act 1994.
32. The Competent Authority expects that all licensed institutions should maintain full and updated records of segregated accounts.

INTERNAL CONTROLS

33. The Competent Authority expects the Board of Directors and Senior Management of licensed institutions to have in place and regularly review sound internal control procedures, that their staff must be aware of and comply with. Sound internal controls are expected to be regularly updated to minimize risk while encouraging effective management. The main internal control *features* are given below.

Sound Knowledge of Counterparty

34. This is an important control function especially in view of legal implications arising, such as the avoidance of money laundering offences. Therefore the

⁶ *Examples of non-core principals are companies and local authorities.*

licensed institution must positively identify the counterparty prior to a transaction.

Dealing Mandates

35. According to circumstances, a licensed institution may deem it necessary to effect a dealing mandate with counterparties. When taken, such mandates are expected to clarify whether the relationship is at arm's length or sets out confirmation procedures, standard settlement instructions and other control procedures.

Record Keeping

36. It is essential that proper records of all transactions are maintained. It is also necessary to maintain records of all conversations with principals that may provide for a speedy resolution of differences. Such records are to be retained for a time frame as stipulated by various statutory requirements. In this regard licensed institutions are to seek professional legal guidance.

After Hours Dealing and Transactions

37. Such transactions may involve additional risks to a licensed institution and senior management must issue clear guidelines to their employees on the types of transactions and the approved limits in such instances.

Conflicts of Interest

38. The nature and extent of any material conflict of interest arising between a licensed institution and parties involved in a transaction should always be disclosed.

Confidentiality

39. The Competent Authority deems the maintenance of confidentiality as being essential for the preservation of a reputable and efficient operation. Licensed institutions are therefore responsible for the maintenance of confidentiality and are expected to be aware of all the relevant statutory requirements.

CONCLUSION

40. In terms of their undertaking of money broking activities, licensed institutions are to ensure compliance with any Banking Directive that may be applied to them in terms of the Financial Institutions Directive FID/02.
41. The provisions of this Policy Document generally apply to both domestic and cross border transactions. In considering cross-border transactions, licensed institutions are to comply with any relevant licence conditions and statutory obligations arising out of any other law of Malta and other regulations and/or

legislation emanating from other foreign jurisdictions. In this respect, the licensed institution is required to seek legal independent advice in order to minimise as much as possible inherent legal risks.

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