MFSA

MALTA FINANCIAL SERVICES AUTHORITY

# Circular addressed to Category 2 and 3 Investment Services Licence Holders regarding the Automatic Execution of Trade Signals

## Background

On 22nd June 2012, the European Securities Markets Authority (ESMA) published an update to the MiFID Questions and Answers (Q&A) in the area of Investor Protection and Intermediaries. The under-mentioned extract (as sourced from the MiFID Q&A) is applicable to those licensed entities which provide an *'automatic execution of trade signals'* service to their customers.

ESMA has considered the above activity within the context of the MiFID provision of services and activities and has subsequently updated the MiFID Q&A. The latter details when the activity of 'automatic execution of trade signals' is a portfolio management service (as defined in MiFID) and, therefore requires authorisation. Moreover, where MiFID applies, on-going regulatory obligations, including the suitability assessment, other conduct of business obligations and the provision of periodic reports to clients and regulators are also triggered.

**Category 2 and 3 licensed entities are urged to examine their investment activities vis a vis the scenario as highlighted in the MiFID Q&A. If the described scenario is deemed applicable, representatives of the concerned licensed entities are urged to contact the Malta Financial Services Authority at their earliest for further guidance.**

## Extract from MiFID Q&A (Investor Protection & Intermediaries)

***"Question 9: Article 4(1)(9) of MiFID - Automatic execution of trade signals***
*Date last updated: June 2012*

**Question**: A service provider X sets up a website which gives its clients the opportunity to choose one or more third parties that provide trade signals (listed on the website). Once the client chooses a signal provider and authorises the service provider to issue orders on his behalf, the service provider transforms each individual signal received into a buy or sell order to be executed by the service provider itself or transmitted for execution to another firm, without further intervention from the client.

Does the service provided by the website provider X fall within any of the investment services listed in Annex I of MiFID?

**Answer:** Article 4(1)(9) of MiFID defines 'portfolio management' as "managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis where such portfolios include one or more financial instruments". This MiFID service is characterised by the fact that investment decisions are implemented without any intervention being necessary by the client other than the conclusion of an agreement ('mandate') between the service provider and the client on the nature and details of the discretionary service to be provided.

In light of this feature, where the service described in the question is provided in relation to MiFID financial instruments, it requires authorisation - in particular, in relation to portfolio management. In the model described, the service provider exercises investment discretion by automatically executing the trade signals of third parties. Where MiFID applies, this triggers associated ongoing regulatory obligations including the suitability assessment, other conduct of business obligations and the provision of periodic reports to clients and regulators.

Where the client sets certain trading parameters such as the amount of money he wishes to invest or is prepared to lose, this will not affect the characterisation of the service as portfolio management.

On the contrary, where no automatic order execution occurs because client action is required prior to each transaction being executed, the activity performed will not amount to portfolio management and, depending on the interaction with the client, other investment services may still be relevant (e.g. investment advice in the case of personal recommendations, and reception and transmission of orders).

Examples of such situations where the investment decisions are taken by the client himself rather than the service provider in regard to the decisions to buy or sell the individual investments in question include the following:

- the trade signals are investment advice (or a general recommendation), and the client is required to confirm each recommendation received in the form of a trading signal before any order is executed or transmitted for execution on his behalf;

- the trade signals themselves are fully determined by the client himself who is required to set the detailed parameters for each signal/order/transaction, such as the precise market conditions that will trigger a particular signal, e.g. the purchase or sale of instrument A when its price on market B reaches level C."

A full version of the MiFID Q&A can be accessed from the following website: http://www.esma.europa.eu/system/files/2012-382.pdf

## Contacts

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