

Circular to the financial services industry on the changes being proposed to the Financial Markets Act (FMA) as a result of the transposition of MiFID II and the implementation of MiFIR

1. Introduction

The financial crisis exposed weaknesses in the transparency of financial markets which could potentially contribute to harmful socio-economic effects. Hence any legislative initiatives had to contribute to strengthening transparency so as to strengthen the financial system.

In order to strengthen the transparency and improve the functioning of the internal market for financial instruments, a new framework providing a more harmonised set of financial regulation was formulated. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (“MiFID”) was partly recast as Regulation 600/2014 of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (“MiFIR”/“the Regulation”) and partly as Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments (“MiFID II”/“the Directive”). Regulation 600/2014 and Directive 2014/65/EU were published in the Official Journal of the European Union on 12th of June of 2014.

Together, both these legal instruments will form the legal framework governing the requirements applicable to investment firms, regulated markets, data reporting services providers and third country firms providing investment services or activities in the Union. MiFIR and MiFID II should thus be considered in conjunction with each other.

2. Regulation (EU) No 600/2014

MiFIR shall be directly applicable in Malta and in all EU Member States with effect from 3rd January 2017.

In view of the requirement to implement MiFIR in the Maltese framework, certain amendments are being proposed to local legislation.

Whilst specific provisions of MiFIR are already directly enforceable, a number of other articles are yet to come into effect or will only enter into force following the adoption of Delegated Acts by the European Commission.

MiFIR establishes *inter alia* uniform regulations in relation to:

- I. disclosure of trade data to the public;
- II. reporting of transactions to the competent authorities;
- III. trading of derivatives on organised venues;
- IV. non-discriminatory access to clearing and non-discriminatory access to trading in benchmarks;
- V. product intervention powers of competent authorities, the European Securities and Markets Authority (“ESMA”) and the European Banking Authority (“EBA”) and powers of ESMA on position management controls and position limits; and
- VI. provision of investment services or activities by third country firms following an applicable equivalence decision by the Commission with or without the establishment of a branch.

Furthermore it should be noted that MiFIR also amends Regulation (EU) No 648/2012 of the European Parliament and of the Council of 4 July 2012 on OTC derivatives, central counterparties and trade repositories.

2.1. Proposed amendments to legislation

➤ *Definitions*

The relevant definitions put forward in MiFIR will be transposed into the Financial Markets Act¹ (“FMA”). These changes will be discussed hereunder in Section 4.

➤ *Designation of the competent authority*

The Malta Financial Services Authority (“MFSA”) will be identified as the competent authority for the purposes of the Regulation and it shall exercise all the functions, obligations and powers and shall satisfy all the requirements imposed on competent authorities by MiFIR.

➤ *Revocation of the Financial Markets Act (Transparency) Regulations, 2007*

It is being proposed that the Financial Markets Act (Transparency) Regulations, 2007 be revoked since their subject matter is now being catered for by MiFIR, which is directly applicable.

¹ Chapter 345 – Laws of Malta

3. Directive 2014/65/EU

MiFID II establishes requirements in relation to:

- I. authorisation and operating conditions for investment firms;
- II. provision of investment services or activities by third-country firms through the establishment of a branch;
- III. authorisation and operation of regulated markets;
- IV. authorisation and operation of data reporting services providers; and
- V. supervision, cooperation and enforcement by competent authorities.

The transposition deadline for MiFID II has been set at 3rd July 2016.

It should also be noted that MiFID II also amends Directive 2002/92/EC of the European Parliament and of the Council of 9 December 2002 on insurance mediation and Directive 2011/61/EU of the European Parliament and of the Council of 8 June 2011 on Alternative Investment Fund Managers.

3.1. Proposed amendments to legislation

➤ *Definitions*

A number of new definitions shall be added to the FMA including new definitions for ‘commodity derivatives’, ‘dealing on own account’, ‘home Member State’, ‘host Member State’, ‘management body’, ‘market maker’, ‘multilateral trading facility’ (‘MTF’), ‘organised trading facility’, ‘OTF’ ‘SME Growth Market’, ‘SME’ and ‘trading venue’. The definitions of ‘market operator’, ‘multilateral system’ and ‘regulated market’ shall be amended to reflect the definitions prescribed in MiFID II.

➤ *Organisational Requirements of regulated markets*

In line with Article 47(2) of the Directive, it is being proposed that a new article disallowing market operators from executing client orders against proprietary capital, or engaging in matched principal trading on any of the regulated markets they operate, is added to the FMA.

➤ *System resilience, circuit breakers and electronic trading*

As per the correlation table in Annex IV to MiFID II, Article 48 is a new addition to the MiFID regime. In this light, it is being proposed that a new article *inter alia* establishing requirements for regulated markets:

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- I. to have in place effective systems, procedures and arrangements which ensure continuity of its services in cases where there is any failure of its trading systems;
- II. to have procedures and arrangements to reject orders that exceed pre-determined volume and price thresholds or are clearly erroneous;
- III. to have the ability to temporarily halt or constrain trading if there is a significant price movement in a financial instrument on that market or a related market during a short period and, in exceptional cases, to be able to cancel, vary or correct any transaction;
- IV. to have effective systems procedures and arrangements to ensure that algorithmic trading systems cannot create or contribute to disorderly trading conditions on the market and to manage any disorderly trading conditions which do arise from such systems;
- V. to ensure that co-location services are transparent, fair and non-discriminatory;
- VI. to ensure that its fee structures are transparent, fair and non-discriminatory; and
- VII. to be able to identify, by means of flagging from members or participants, orders generated by algorithmic trading, the different algorithms used for the creation of orders and the relevant persons initiating those orders. Moreover, upon request by the competent authority of the home Member State of a regulated market, a regulated market shall make available to the competent authority data relating to the order book or give the competent authority access to the order book so that it is able to monitor trading.

➤ *Tick Sizes*

In line with Article 49 of the Directive, it is being proposed that the FMA requires regulated markets to adopt tick size regimes in shares, depositary receipts, exchange-traded funds, certificates and other similar financial instruments and in any other financial instrument for which regulatory technical standards are developed.

➤ *Synchronisation of Business Clocks*

It is being proposed that the FMA requires that all trading venues (a term which as per the new definition includes regulated markets, MTFs and OTFs) synchronise the business clocks they use to record the date and time of any reportable event.

➤ *List of Members or participants of the regulated market*

It is being proposed that the FMA requires that the market operator communicates, on a regular basis, the list of the members or participants of the regulated market to the competent authority of the regulated market.

➤ *Suspension and Removal from trading*

Changes in the FMA are being proposed to require that in cases where a market operator suspends or removes a financial instrument from trading, any derivatives as referred to in

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points (4) to (10) of Section C of Annex I to MiFID shall likewise be suspended or removed. Furthermore, it is also being proposed that the competent authority shall require other regulated markets, MTFs, OTFs and systematic internalisers which fall under its jurisdiction and trade the same financial instrument or derivatives thereof to also suspend or remove that financial instrument or derivative instrument from trading, except where such suspension or removal could cause significant damage to the interests of investors or the orderly functioning of the market.

➤ *Power to require information*

It is being proposed that Article 32 (1) of the FMA is extended to include any data reporting services provider that appears to be in possession of relevant information.

➤ *Cooperation with European regulatory authorities*

It is being proposed that a number of sub-articles are added to Article 37 of the FMA to provide further for instances where the MFSA would be obliged to cooperate with other competent authorities and/or ESMA.

➤ *Cooperation with overseas regulatory authorities*

A new sub-article empowering the MFSA to conclude cooperation agreements with third country authorities in certain circumstances is being proposed.

➤ *Binding Mediation*

In line with Article 82 of the Directive, a new article is being proposed, granting the possibility to the competent authority to refer situations to ESMA where a request relating to either [i] the carrying out of a supervisory activity, on-the-spot verification, or an investigation; or [ii] to exchange information has not been acted upon within reasonable time or has been rejected.

➤ *Administrative Penalties*

It is being proposed that where the provisions of MiFIR and MiFID are infringed, the maximum administrative fines are increased to €5,000,000 for natural persons and, in the case of legal persons, to €5,000,000 or an administrative fine of up to 10% of the total annual turnover of the legal person according to the last available accounts approved by the management body. Furthermore, it is also being proposed that where the benefit derived from such an infringement can be determined, the competent authority shall impose an administrative fine of at least twice the amount of the benefit derived from the infringement even if it exceeds the maximum amounts specified above.

➤ *SME Growth Markets*

A new Part VIII addressing SME Growth Markets is being proposed. As per the new definition introduced by the Directive, an SME Growth market is an MTF that is registered as an SME Growth Market. The operators of an MTF will now be able to apply to the competent authority to have the MTF registered as an SME growth market in so far as the MTF satisfies the requirements set out.

➤ *Proposed new regulations on central counterparties (“CCPs”)*

New regulations providing for access to CCPs is being proposed. A CCP is defined as a legal person that interposes itself between counterparties to the contracts traded on one or more financial markets becoming the buyer to every seller and the seller to every buyer. It is being proposed that investment firms from other Member States shall have the right of direct and indirect access to CCPs. Moreover regulated markets will be obliged to offer all their members or participants the right to designate the system for the settlement of transactions in financial instruments subject to certain conditions.

➤ *Proposed amendments to the Regulated Markets (Authorisation Requirements) Regulations*

The Schedule (Regulation 3) Authorisation requirements will be brought in line with the MiFID II provisions which delineate the functions and obligations of the management body of a regulated market. The management body shall be required to possess adequate collective knowledge, skills and experience to be able to understand the market operator’s activities, including the main risks and market operators shall be obliged to devote adequate human and financial resources to the induction and training of members of this body. The proposed amendments also set out the obligation of market operators which are significant in terms of their size, internal organisation and the nature, scope and complexity of their activities to establish a nomination committee composed of members of the management body who do not perform any executive function in the market operator concerned. The functions of the nomination committee will also be set out.

➤ *Proposed amendments to the European Rights for Regulated Markets Regulations*

It is being proposed that a new obligation for competent authorities to establish proportionate cooperation arrangements is added to the European Rights for Regulated Markets Regulations.

➤ *Proposed new regulations on Data Reporting Services*

New regulations for data reporting services are being proposed. Data reporting services shall include the operation of an approved publication arrangement (“APA”), consolidated tape provider (“CTP”) or approved reporting mechanism (“ARM”). The authorisation and

organisational requirements for data reporting services providers shall be set out in this new Legal Notice.

➤ *Proposed new regulations on position limits and position management controls in commodity derivatives and reporting regulations*

A new Legal Notice on position limits and position management controls in commodity derivatives and reporting is being proposed. In this new proposed Legal Notice, the competent authority [i] will establish and apply position limits on the size of a net position which a person can hold in commodity derivatives traded on trading venues and economically equivalent OTC contracts; [ii] set limits for each contract in commodity derivatives traded on trading venues; and [iii] set single position limits to be applied on all trading in a particular contract where the same commodity derivative is traded in significant volumes on trading venues in more than one jurisdiction and the largest volume of trading takes place in Malta. The new Legal Notice would also require an investment firm or market operator operating a trading venue which trades commodity derivatives to apply position management controls.

4. Queries

Any queries in relation to this circular can be addressed to Edward Grech, Senior Manager, Securities and Markets Supervision Unit by e-mail on egrech@mfsa.com.mt or Gerd Sapiano, Analyst, Securities and Markets Supervision Unit by e-mail on gsapiano@mfsa.com.mt.

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