

Circular to the financial services industry on the changes being proposed to the Investment Services Act (ISA) as a result of the transposition of MiFID II and the implementation of MiFIR

1. Introduction

In order to strengthen the transparency and improve the functioning of the internal market for financial instruments following the financial crisis, a new framework providing a more harmonised set of financial regulation has been formulated. Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments (“MiFID”) has been 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 12 June of 2014.

Together, MiFID II and MiFIR 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.

2. Regulation (EU) No 600/2014

MiFIR will be directly applicable in Malta and in all other EU Member States and is expected to come into effect on 3 January 2018. However, in view of the requirement to implement MiFIR in the Maltese framework, certain amendments to local legislation are being proposed.

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”), as well as the 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.

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.

2.1. Summary of the main proposed legislative amendments

➤ Definitions

The relevant definitions put forward in MiFIR will be transposed into the Investment Services Act¹ (“the ISA”). These changes will be discussed hereunder in Section 3.

➤ Designation of the competent authority

The Malta Financial Services Authority (“the MFSA”/ “the Authority”) 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.

3. Directive 2014/65/EU

Being a directive, MiFID II requires transposition into Maltese law with the transposition deadline set at 3 July 2016.

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.

¹ Chapter 370 – Laws of Malta

3.1. *Proposed amendments to legislation*

➤ *Definitions*

A number of new definitions shall be added to the ISA including, *inter alia*, definitions for “ancillary services”, “central counterparty” (“CCP”), “commodity derivatives”, “derivatives”, “market operator”, “multilateral system”, “multilateral trading facility” (“MTF”), “organised trading facility” (“OTF”), and “trading venue”.

➤ *The Authority’s Power to issue directives*

It is being proposed that the Authority’s power to issue directives will be extended and it will be possible for the Authority to [i] require the suspension of trading in a financial instrument; [ii] request any person to take steps to reduce the size of a position or exposure; and [iii] limit the ability of any person from entering into a commodity derivative, including by introducing limits on the size of a position any person can hold at all times.

➤ *Proposed changes to the First Schedule to the ISA*

In line with the Directive, it is being proposed that the “operation of an organised trading facility” is added as an investment service.

➤ *Proposed changes to the Second Schedule to the ISA*

It is being proposed that paragraphs 4, 5, 6, 7 and 10 are amended in order to better reflect the wording given by the Directive. Furthermore, it is also being proposed that a new instrument – “emission allowances consisting of any units recognised for compliance with the requirements of Directive 2003/87/EC” – is added.

➤ *Proposed insertion of a new Third Schedule to the ISA*

The insertion of a new third schedule to the ISA identifying ancillary services is being proposed.

➤ *Proposed amendments to the Investment Services Act (Exemption) Regulations*

In line with Article 2 of MiFID, it is being proposed that the Exemption Regulations are amended. A number of new regulations are being proposed whilst amendments to some of the existing regulations are being suggested in order for national legislation to better reflect the wording of the Directive.

➤ *Proposed amendments to the European Passport Rights for Investment Firms Regulations*

In line with Articles 34 and 35 of MiFID, a number of amendments are being proposed to these regulations. Furthermore, a number of amendments are also being proposed in order for these regulations to be made more in line with the wording of the directive.

➤ *Proposed amendments to the European Passport Rights for Persons operating Multilateral Trading Facilities Regulations*

It is being proposed that the regulations on “European Passport Rights for Persons operating Multilateral Trading Facilities” are amended in order to include organised trading facilities within the scope of the regulations. In this light, it is being proposed that the title of these regulations is changed to the “European Passport Rights for Persons operating Multilateral Trading Facilities or Organised Trading Facilities Regulations”. It is *inter alia* also being proposed that, in line with Article 34(7) of MiFID, the words “within a reasonable delay”, as used in regulation 4(4), are substituted by the words “without undue delay”. Furthermore, a new Part IV establishing requirements regarding cooperation between competent authorities is being proposed.

➤ *Proposed amendments to the Control of Assets Regulations*

Amendments to these regulations are being proposed in line with the Commission Delegated Directive supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to safeguarding of financial instruments and funds belonging to clients, product governance obligations and the rules applicable to the provision or reception of fees, commissions or any monetary or non-monetary benefits.

➤ *Proposed new regulations on Algorithmic Trading*

It is being proposed that Article 17 of MiFID is transposed by means of a new legal notice on algorithmic trading. Investment firms that engage in algorithmic trading will be required to have in place appropriate systems and controls for this activity.

➤ *Proposed new regulations on MTFs and OTFs*

A new legal notice on MTFs and OTFs is being proposed in order to set out: [i] the requirements for the trading process and finalisation of transactions in an MTF and an OTF; [ii] the specific requirements for MTFs; [iii] the specific requirements for OTFs; [iv] the monitoring of compliance with the rules of the MTF or the OTF and with other legal obligations; and [v] the suspension and removal of financial instruments from trading on an MTF or an OTF.

➤ *Proposed new regulations on Provision of Investment Services and Activities by Third Country Firms*

As per the correlation table in Annex IV to MiFID II, Articles 39 to 43 are new additions to the MiFID regime. It is being proposed that these articles are transposed by virtue of a new Legal Notice *inter alia* setting out requirements vis-à-vis: [i] the establishment of branches by third country firms; [ii] the obligation of third country firms to provide certain information to

the competent authority; [iii] the authorisation requirements for the establishment of such branches; [iv] the provision of services at the exclusive initiative of the client; and [v] withdrawal of authorisations granted under the proposed regulations.

➤ *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 legal person's 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.

➤ *Conduct of Business Rulebook*

A number of articles which *inter alia* include Article 9 (Management Body), Articles 16 (Organisational requirements) and articles 23 to 30 (Provisions to ensure investor protection) will be transposed within a new Conduct of Business Rulebook. In this regard, a consultation document has been issued under separate cover.

➤ *Changes to the Investment Services Rules for Investment Services Providers (ISRISPs)*

Changes will also be made to the ISRISPs to ensure that [i] there is no overlap with the Conduct of Business Rulebook and [ii] there is compliance with MiFIR and MiFID II.

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.

Communications Unit
Malta Financial Services Authority
03 May, 2016