

## **INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS**

### **PART BII: STANDARD LICENCE CONDITIONS APPLICABLE TO INVESTMENT SERVICES LICENCE HOLDERS WHICH QUALIFY AS UCITS MANAGEMENT COMPANIES**

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#### **Introduction**

Part BII of the Investment Services Rules for Investment Services Providers applies to Investment Services Licence Holders which provide services in terms of the Directive 2009/65/EC. Therefore, Part BII does not apply to Investment Services Licence Holders which qualify as MiFID Firms, Alternative Investment Fund Managers or Custodians.

#### **1. General Requirements**

1.01 The Licence Holder shall not engage in activities other than the management of UCITS, with the exception of the additional management of other Schemes which are not UCITS but the units of which cannot be marketed in other Member States or EEA States and for which the Licence Holder is subject to the MFSA's prudential supervision.

The activity of "Management of a UCITS" shall include the following functions:

- Investment management.
- Administration:
  - a. legal and fund management accounting services;
  - b. customer inquiries;
  - c. valuation and pricing (including tax returns);
  - d. regulatory compliance monitoring;
  - e. maintenance of unit-holder register;
  - f. distribution of income;
  - g. unit issues and redemptions;
  - h. contract settlements (including certificate dispatch);
  - i. record keeping.

– Marketing.

1.02 Without prejudice to SLC 1.01, the MFSA may authorise the Licence Holder to provide, in addition to the Management of UCITS, the following services:

- a. management of portfolios of investments including those owned by pension funds, in accordance with mandates given by investors on a discretionary,

client-by-client basis, where such portfolios include one or more of the instruments listed in the Act;

- b. as non-core services:
  - i. investment advice concerning one or more of the instruments listed in the Act;
  - ii. safekeeping and administration in relation to units of collective investment undertakings.

1.03 The A Licence Holder shall not engage in activities other than the management of UCITS Schemes, with the exception of the additional management of other Schemes which are not UCITS but the units of which cannot be marketed in other Member States or EEA States and for which the Licence Holder is subject to the MFSA's prudential supervision.

1.04 The following SLCs shall apply to the provision of services referred to in SLC 1.02 by Licence Holders:

- a. SLC 10.2 of Part A of these Rules;
- b. Schedule C to Part A of these Rules;
- c. SLCs 1.04, 1.17 to 1.29, 2.01 to 2.03, 2.05 to 2.06, 2.13 to 2.27 to 2.30, 2.31 to 2.53, 2.59 to 2.69, 2.74 to 2.81, 2.83 to 2.85, 2.86 to 2.89, 2.90 to 2.94, 2.96 to 2.103, 2.105, 2.111 to 2.113, 2.117, 3.01 to 3.23, 4.01 to 4.10, 6.01 to 6.14, 7.01 to 7.04, 7.06 to 7.14, 7.32(e) of Part BI of these Rules;
- d. Appendices 1 and 2 of these Rules;
- e. Investment Services Act (Control of Assets) Regulations (Part 2 Regulations 3, 5 and 7);
- f. European Passport Rights for Investment Firms Regulations – Regulation 6; and
- g. Part CI of these Rules.

1.05 The Licence Holder shall not be authorised to provide only the services referred to in SLC 1.02, or to provide non-core services referred to in SLC 1.02(b) without being authorised for the services referred to in SLC 1.02(a).

1.06 The Licence Holder shall commence its Investment Services business within twelve months of the date of issue of the Investment Services Licence.

If, for any reason the Licence Holder is not in a position to comply with this condition, it shall notify the MFSA in writing setting out the reason/s for such a delay together with an updated business plan indicating the proposed date of commencement of business. On the basis of the information provided and the circumstances of the case, the MFSA may decide to suspend or cancel the Licence in accordance with the relevant provisions of the Act.

- 1.07 The Licence Holder shall co-operate in an open and honest manner with the MFSA and inform it promptly of any relevant information. The Licence Holder shall supply the MFSA with such information and returns as the MFSA requires.
- 1.08 Where a Standard Licence Condition demands that the Licence Holder notifies the MFSA of an event, such notification shall be made to the MFSA formally, in a durable medium. The request to notify the MFSA of an event shall not be satisfied merely by the fact that the information which ought to be notified to the MFSA is included in a standard regulatory return.
- 1.09 The Licence Holder's Investment Services Business shall be effectively directed or managed by at least two individuals in satisfaction of the "dual control" principle. Such persons shall be of sufficiently good repute and sufficiently experienced so as to ensure the sound and prudent management of the Licence Holder.

Moreover, the Licence Holder shall take reasonable steps to ensure continuity and regularity in the performance of Investment and Ancillary Services. To this end, the Licence Holder shall employ appropriate and proportionate systems, resources and procedures.

- 1.10 The Licence Holder shall notify the MFSA in writing of:
- a. a change in the Licence Holder; name or business name (if different) at least one month in advance of the change being made;
  - b. a change of address: at least one month in advance;
  - c. the departure of a Director or Senior Manager: within 14 days of the departure. The Licence Holder shall also request the Director or Senior Manager to confirm to MFSA that their departure had no regulatory implications or to provide relevant details as appropriate. A copy of such request shall be provided to MFSA together with the Licence Holder's notification of departure;
  - d. the ultimate beneficial ownership of any party directly or indirectly controlling 10 per cent or more of the Licence Holder's share capital on becoming aware of the situation;
  - e. any acquisitions or disposals of shares which fall within the disclosure provisions of Article 10 of the Act – immediately upon becoming aware of the proposed acquisition or disposal. It should be noted that MFSA has the right to object to such an acquisition;
  - f. any proposed material change to its business (whether that business constitutes licensable activity under the Act or not) – at least one month before the change is to take effect (where a new or amended Investment Services Licence is

required, the new business shall not begin until the new Investment Services Licence has been granted or the amendment has been approved);

- g. any evidence of fraud or dishonesty by a member of the Licence Holder's staff immediately upon becoming aware of the matter;
- h. a decision to make a material claim on any insurance policy held in relation to the Licence Holder's Investment Services business. Notification should be provided as soon as the decision is taken;
- i. any actual or intended legal proceedings of a material nature by or against the Licence Holder immediately after the decision has been taken or on becoming aware of the matter;
- j. any material changes in the information supplied to the MFSA – immediately upon becoming aware of the matter. This shall include the obligation to notify the MFSA on a continuous basis of any changes or circumstances which give rise to the existence of close links, as defined in Appendix 9, between the Licence Holder and any other person;
- k. the fact, where applicable, that it has not provided any Investment Service or carried out any investment activity for the preceding six months, setting out the reasons for such inactivity and providing a business plan for future activity;
- l. the relevant details required pertaining to any introducers which may be appointed by the Licence Holder.

1.11 The Licence Holder shall obtain the written consent of the MFSA before:

- a. making any change to its share capital or the rights of its shareholders;
- b. establishing a branch in Malta or abroad;
- c. acquiring 10 per cent or more of the voting share capital of another company;
- d. taking any steps to cease its investment services business;
- e. agreeing to sell or merge the whole or any part of its undertaking;
- f. making application to a Regulator abroad to undertake any form of licensable activity outside Malta;
- g. the appointment of a Director or Senior Manager responsible for the Investment Services business of the Licence Holder or of the Licence Holder's Compliance Officer in terms of SLC 2.19 and/ or Money Laundering Reporting Officer, in advance. The request for consent of the appointment shall be accompanied by a

Personal Questionnaire (“PQ”), in the form set out in Schedule F of these Rules – duly completed by the person proposed, which shall in the case of a proposed Compliance Officer and/ or Money Laundering Reporting Officer, include sufficient details of the individual’s background, training and/ or experience relevant to the post, to enable an adequate assessment by the MFSA.

In the case of a proposed Compliance Officer and/or Money Laundering Reporting Officer, the request shall also be accompanied by the Competency Form set out in Schedule I to Part A of these Rules.

Where the person proposed had within the previous five years submitted a PQ to the MFSA, the request for consent need not be accompanied by a new PQ. In such instances, it shall be accompanied by a confirmation by the proposed person as to whether the information included in the PQ previously submitted is still current, and indicating any changes or up-dates thereto. This confirmation is to be countersigned by an authorised official of the Licence Holder, confirming that he/she has seen the said PQ.

For the purposes of the above and (h) below, ‘Senior Manager’ should be interpreted as the person occupying the most senior role following that of Director, so that in the case where there are various management grades, it is the most senior manager who will require the MFSA’s authorisation.

- h. the change in the responsibilities of a Director or Senior Manager in advance. The request for consent of the change in responsibilities of a Director or Senior Manager shall be accompanied by a PQ unless the individual concerned had within the previous three years submitted a PQ to the MFSA in connection with another role occupied by such individual with the same Licence Holder, in which case it shall be accompanied by a confirmation by the Director or Senior Manager as to whether the information included in the PQ previously submitted is still current, and indicating any changes or up-dates thereto;

A change in the responsibilities of a Director or Senior Manager should only be notified to the MFSA when such a change is material, which shall include a change in the status or seniority of the person concerned (upwards or downwards);

- i. any persons, whether Directors, Senior Managers or other employees are engaged in any of the following activities:
  - Portfolio management
  - Risk management
  - Investment advice

The request for authorisation shall include all relevant details in order to enable the MFSA to assess whether the persons concerned are sufficiently competent to undertake such activities. For this purpose, details of relevant experience, training and/or qualifications will be required. Applicants should also complete Sections 4, 5, 6 and 7 of the Application for an Investment Services Licence (Schedule A to these Rules).

- 1.12 The Licence Holder shall maintain sufficient records to be able to demonstrate compliance with the conditions of its Investment Services Licence and as required by SLCs 2.49 to 2.52.
- 1.13 The Licence Holder shall co-operate fully with any inspection or other enquiry, or compliance testing carried out by the MFSA, or an inspector acting on its behalf.
- 1.14 The Licence Holder shall pay promptly all amounts due to the MFSA.
- 1.15 The Annual Supervisory Fee shall be payable by the Licence Holder on the day the Licence is first issued and, and thereafter upon submission of the annual audited financial statements.
- 1.16 The Licence Holder shall notify the MFSA of any breach of the conditions of the Licence as soon as the Licence Holder becomes aware of the breach.
- 1.17 If so required by the MFSA, the Licence Holder shall do all in its power to delay the cessation of its Investment Services business or the winding up of such business so as to comply with the conditions imposed by the MFSA in order to protect the interests of customers.
- 1.18 A request for a variation of a Licence by the Licence Holder shall be submitted to the MFSA in writing, giving details of the variation and the reasons therefore.
- 1.19 The Licence Holder shall establish, implement and maintain effective, appropriate and transparent procedures and arrangements to ensure that it deals promptly and reasonably with investor complaints.

In complying with this SLC, the Licence Holder shall also comply with Appendix 16 to these Rules.

- 1.20 Information regarding the procedures for investor complaints shall be made available to investors free of charge.
- 1.21 An investor shall be able to file a complaint free of charge. A complaint may be made in language of the Member State or EEA State where the UCITS is marketed.
- 1.22 The Licence Holder shall record each complaint and the measures taken for its resolution.

- 1.23 The Licence Holder shall establish appropriate procedures and arrangements to make information available at the request of the public or the European authority of the UCITS home Member State or EEA State.

## 2 Administrative Procedures and Internal Control Mechanisms

### 2.01 The Licence Holder shall:

- a. have sound administrative and accounting procedures, control and safeguard arrangements for electronic data processing and adequate internal control mechanisms. In particular these will include rules for personal transactions by its employees or for the holding or management of investments in financial instruments in order to invest own funds and ensuring at least, that each transaction involving the UCITS may be reconstructed according to its origin, the parties to it, its nature, and the time and place at which it was effected and that the assets of the UCITS managed by the Licence Holder are invested according to the memorandum and articles of association, the prospectus and the legal provisions in force;
- b. be structured and organised in such a way as to minimise the risk of UCITS' or clients' interests being prejudiced by conflicts of interest between it and its clients, between two of its clients, between one of its clients and a UCITS or between two UCITS.

### 2.02 Where the Licence Holder is also authorised to provide the services referred to in SLC 1.02(a), it shall, with regard to such services:

- a. refrain from investing, in whole or in part, the investor's portfolio in units of collective investment undertakings it manages unless it receives prior general approval from the client;
- b. be subject to the provisions of the Investor Compensation Scheme Regulations.

### 2.03 The Licence Holder shall:

- a. establish, implement and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;
- b. ensure that its relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities;
- c. establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the Licence Holder;
- d. establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the Licence Holder as well as effective information flows with any third party involved;

- e. maintain adequate and orderly records of its business and internal organisation;
- f. establish, implement and maintain systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question;
- g. establish, implement and maintain an adequate business continuity policy aimed at ensuring, in the case of an interruption to their systems and procedures, the preservation of essential data and functions, and the maintenance of services and activities, or where that is not possible, the timely recovery of such data and functions and the timely resumption of their services and activities;
- h. establish, implement and maintain accounting policies and procedures that enable it, at the request of the MFSA, to deliver in a timely manner to the MFSA financial reports which reflect a true and fair view of their financial position and which comply with all applicable accounting standards and rules;
- i. monitor and evaluate the adequacy and effectiveness of their systems, internal control mechanisms and arrangements on a regular basis in accordance with indents (a) to (h) above and to take appropriate measures to address any deficiencies.

The requirements prescribed in indents (a) to (i) above shall apply depending on the nature, scale and complexity of the Licence Holder's business, and the nature and range of services and activities undertaken in the course of that business.

#### 2.04 The Licence Holder shall:

- a. employ personnel with the skills, knowledge and expertise necessary for the discharge of the responsibilities allocated to them;
- b. retain the necessary resources and expertise so as to effectively monitor the activities carried out by third parties on the basis of an arrangement with a Licence Holder, especially with regard to the management of the risk associated with those arrangements;
- c. ensure that the performance of multiple functions by relevant persons does not and is not likely to prevent those relevant persons from discharging any particular function soundly, honestly and professionally.

The requirements prescribed in indents (a) to (c), shall apply depending on the nature, scale and complexity of a Licence Holder's business, and the nature and range of services and activities undertaken in the course of that business.

### **Electronic Data Processing**

- 2.05 The Licence Holder shall make appropriate arrangements for suitable electronic systems so as to permit a timely and proper recording of each portfolio transaction or subscription or redemption order to be able to comply with the requirements prescribed in SLCs 2.46 to 2.48.
- 2.06 The Licence Holder shall ensure a high level of security during the electronic data processing as well as integrity and confidentiality of the recorded information, as appropriate.

### **Accounting Procedures**

- 2.07 The Licence Holder shall ensure the employment of accounting policies and procedures as referred to in SLC 2.03(h) so as to ensure the protection of unit-holders.
- 2.08 The Licence Holder shall keep UCITS accounting in such a way that all assets and liabilities of the UCITS can be directly identified at all times.
- 2.09 Where a UCITS has different investment compartments, separate accounts shall be maintained for those investment compartments.
- 2.10 The Licence Holder shall:
- a. establish, implement and maintain accounting policies and procedures in accordance with the accounting rules prescribed by the UCITS' home Member State or EEA State so as to ensure that the calculation of the net asset value of each UCITS is accurately effected on the basis of the accounting and that subscription and redemption orders can be properly executed at that net asset value;
  - b. establish appropriate procedures to ensure the proper and accurate valuation of the assets and liabilities of the UCITS, as consistent with the Investment Services Rules for Retail Collective Investment Schemes on valuation of assets.

### **Control by Senior Management and Supervisory Function**

- 2.11 When allocating functions internally, the Licence Holder shall ensure that senior management and the supervisory function, where appropriate, are responsible for the Licence Holder's compliance with its obligations under the Act and any applicable regulations and Investment Services Rules issued thereunder.
- 2.12 The Licence Holder shall ensure that its senior management:
- a. is responsible for the implementation of the general investment policy for each managed UCITS, as defined, where relevant, in the prospectus, the

- memorandum and articles of association or the instruments of incorporation of the investment company;
- b. oversees the approval of investment strategies for each managed UCITS;
  - c. is responsible for ensuring that the Licence Holder has a permanent and effective compliance function as referred to in SLCs 2.17 to 2.20 even where such function is performed by a third party;
  - d. ensures and verifies on a periodic basis that the general investment policy, the investment strategies and the risk limits of each managed UCITS are properly and effectively implemented and complied with, even if the risk management function is performed by third parties;
  - e. approves and reviews on a periodic basis the adequacy of the internal procedures for undertaking investment decision for each managed UCITS, so as to ensure that such decisions are consistent with the approved investment strategies;
  - f. approves and reviews on a periodic basis the risk management policy and arrangements, processes and techniques for implementing that policy, as referred to in SLCs 2.34 to 2.38 hereunder.
- 2.13 In addition to the requirements prescribed in SLC 2.12, the Licence Holder shall also ensure that its senior management and, where appropriate, its supervisory function shall:
- a. assess and periodically review the effectiveness of the policies, arrangements and procedures implemented to comply with the provisions of the Act and any applicable regulations and Investment Services Rules issued thereunder;
  - b. take appropriate measures to address any deficiencies.
- 2.14 The Licence Holder shall ensure that the senior management and, where applicable, the supervisory function, receive on a frequent basis, and at least annually, written reports on matters of compliance, internal audit and risk management indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies.
- 2.15 The Licence Holder shall ensure that the senior management receives regular reports on the implementation of investment strategies and of the internal procedures for taking investment decisions referred to in SLC 2.12 (b) to (e).
- 2.16 A UCITS Licence Holder shall ensure that the supervisory function, if any, receives on a regular basis written reports on the matters referred to in SLC 2.14.

### Permanent Compliance Function

2.17 The Licence Holder shall establish, implement and maintain adequate policies and procedures designed to detect any risk of failure to comply with the obligations prescribed by the Act and any applicable regulations and Investment Services Rules issued thereunder. The Licence Holder shall also establish, implement and maintain adequate policies and procedures designed to detect any risk of failure to comply with its obligations under other applicable legislation, in particular the Prevention of Money Laundering Act, 1994, the Prevention of Financial Markets Abuse Act, 2005 and any regulations issued thereunder, as well as other associated risks, and shall put in place adequate measures and procedures designed to minimise such risks and to enable the competent authority to exercise its powers effectively.

This requirement shall apply depending on the nature, scale and complexity of the Licence Holder's business, and the nature and range of services and activities undertaken in the course of that business.

2.18 The Licence Holder shall establish and maintain a permanent and effective compliance function which operates independently and which has the following responsibilities:

- a. to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures, policies and procedures implemented in accordance with SLC 2.17, and the actions taken to address any deficiencies in a Licence Holder's compliance with its obligations;
- b. to advise and assist the relevant persons responsible for carrying out services and activities to comply with the Licence Holder's obligations under the Act and any applicable regulations and Investment Services Rules issued thereunder.

2.19 In order to enable the compliance function established in SLC 2.18 to discharge its responsibilities properly and independently, the Licence Holder shall ensure that the following conditions are satisfied:

- a. the compliance function shall have the necessary authority, resources, expertise and access to all relevant information;
- b. a compliance officer, duly approved by the MFSA, shall be appointed and shall be responsible for the compliance function and for any reporting on a frequent basis, and at least annually, to the senior management on matters of compliance, indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies;
- c. the person appointed to fulfil the role of compliance officer may also act as the Licence Holder's Money Laundering Reporting Officer;

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

In complying with SLCs 2.17 to 2.19, the Licence Holder is expected to take into account the Guidelines as issued by ESMA on certain aspects of the MiFID compliance function requirements. These Guidelines may be downloaded from ESMA's website: [https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-388\\_en.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-388_en.pdf).

- 2.20 The Licence Holder shall not be required to comply with the requirements prescribed in SLC 2.19 (d) and (e) where it is able to demonstrate that in view of the nature, scale and complexity of its business, and the nature and range of its services and activities, such requirement is not proportionate and that its compliance function continues to be effective.
- 2.21 The Licence Holder shall appoint a Money Laundering Reporting Officer to ensure compliance with its Prevention of Money Laundering obligations. Such Money Laundering Reporting Officer shall be duly approved by the MFSA, and may be the same person appointed to fulfil the role of compliance officer in accordance with SLC 2.19.
- 2.22 The MFSA reserves the right to object to the proposed appointment or replacement of a Money Laundering Reporting Officer and to require such additional information it considers appropriate.

## **Permanent Internal Audit Function**

- 2.23 Where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of collective portfolio management activities undertaken in the course of that business, the Licence Holder shall establish and maintain an internal audit function which is separate and independent from its the other functions and activities.
- 2.24 The internal audit function shall have the following responsibilities:
  - a. to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the Licence Holder's systems, internal control mechanisms and arrangements;
  - b. to issue recommendations based on the result of work carried out in accordance with paragraph (a);

- c. to verify compliance with the recommendations referred to in paragraph (b);
- d. to report in relation to internal audit matters in accordance with SLC 2.14.

### **Permanent Risk Management Function**

- 2.25 The Licence Holder shall employ a risk management process which enables it to monitor and measure at any time the risk of the positions and their contribution to the overall risk profile of the portfolio of a UCITS. In particular, the Licence Holder shall not solely or mechanistically rely on credit ratings issued by credit rating agencies as defined in Article 3(1)(b) of Regulation (EC) No 1060/2009 of the European Parliament and of the Council of 16 September 2009 on credit rating agencies, for assessing the creditworthiness of the UCITS' assets.
- 2.26 The Licence Holder shall employ a process for accurate and independent assessment of the value of OTC derivatives.
- 2.27 The Licence Holder shall regularly report to the MFSA on the types of derivative instruments, the underlying risks, the quantitative limits and the methods which are chosen in order to estimate the risks associated with transactions in derivative instruments regarding each managed UCITS.
- 2.28 The Licence Holder shall comply with the requirements prescribed hereunder with regards to the risk management function as well as with the requirements prescribed in Appendix 11 on risk management processes, counterparty risk exposure and issuer concentration.
- 2.29 The Licence Holder shall establish and maintain a permanent risk management function which shall be hierarchically and functionally independent from the operating units.
- 2.30 The MFSA may grant a derogation from the obligation pursuant to SLC 2.29 where such derogation is appropriate and proportionate in view of the nature, scale and complexity of the Licence Holder's business and of the UCITS it manages.
- 2.31 The Licence Holder shall be able to demonstrate that appropriate safeguards against conflicts of interest have been adopted so as to allow an independent performance of risk management activities and that its risk management process satisfies the requirements on risk management prescribed in SLCs 2.25 to 2.27 and in the Investment Services Rules for Retail Collective Investment Schemes.
- 2.32 The permanent risk management function shall:
  - a. implement the risk management policy and procedures;

- b. ensure compliance with the UCITS risk limit system, including statutory limits concerning global exposure and counterparty risk in accordance with Appendix 11 stipulating risk management processes, counterparty risk exposure and issuer concentration;
  - c. provide advice to the board of directors as regards the identification of the risk profile of each managed UCITS;
  - d. provide regular reports to the board of directors and, where possible, the supervisory function, on:
    - i. the consistency between the current levels of risk incurred by each managed UCITS and the risk profile agreed for that UCITS;
    - ii. the compliance of each managed UCITS with relevant risk limit systems;
    - iii. the adequacy and effectiveness of the risk management process, indicating in particular whether appropriate remedial measures have been taken in the event of any deficiencies;
    - iv. provide regular reports to the senior management outlining the current level of risk incurred by each managed UCITS and any actual or foreseeable breaches to their limits, so as to ensure that prompt and appropriate action can be taken;
    - v. review and support where appropriate, the arrangement and procedures for the valuation of OTC derivatives as referred to in Appendix 11.
- 2.33 The permanent risk management function shall have the necessary authority and access to all the relevant information necessary to fulfil the tasks set out in SLC 2.32.

## **Risk Management Policy**

- 2.34 The Licence Holder shall establish, implement and maintain an adequate and documented risk management policy which identifies the risks the UCITS it manages are or might be exposed to.
- 2.35 The risk management policy shall comprise such procedures as are necessary to enable the Licence Holder to assess for each UCITS it manages the exposure of that UCITS to market, liquidity and counterparty risks, and the exposure of the UCITS to all other risks, including operational risks, which may be material for each UCITS it manages.
- 2.36 The Licence Holder shall address at least the following elements in the risk management policy:

- a. the techniques, tools and arrangements that enable them to comply with the obligations stipulated in Appendix 11;
  - b. the allocation of responsibilities within the Licence Holder pertaining to risk management.
- 2.37 The Licence Holder shall ensure that the risk management policy referred to in SLCs 2.34 to 2.36 states the terms, contents and frequency of reporting of the risk management function referred to in SLCs 2.29 to 2.33 above to the board of directors and to senior management and, where appropriate, to the supervisory function.
- 2.38 For the purposes of SLCs 2.34 to 2.37, the Licence Holder shall take into account the nature, scale and complexity of its business and of the UCITS it manages.

### **Assessment, Monitoring and Review of Risk Management Policy**

- 2.39 The Licence Holder shall assess, monitor and periodically review:
- a. the adequacy and effectiveness of the risk management policy and of the arrangements, processes and techniques referred to in Appendix 11;
  - b. the level of compliance by the Licence Holder with the risk management policy and with arrangements, processes and techniques referred to in Appendix 11;
  - c. the adequacy and effectiveness of measures taken to address any deficiencies in the performance of the risk management process.
- 2.40 The Licence Holder shall notify the MFSA of any material changes to the risk management process.
- 2.41 The requirements prescribed in SLC 2.39 shall be subject to review by the MFSA both at the application stage and on an on-going basis following the granting of a licence.

### **Personal Transactions**

- 2.42 The Licence Holder shall establish, implement and maintain adequate arrangements aimed at preventing the following activities in the case of any relevant person who is involved in activities that may give rise to a conflict of interest, or who has access to inside information within the meaning of article 2(1) of the Prevention of Financial Markets Abuse Act, 2005 or to other confidential information relating to UCITS or transactions with or for UCITS by virtue of an activity carried out by him on behalf of the UCITS:

- a. entering into a personal transaction which fulfils at least one of the following criteria:
    - i. that person is prohibited from entering into that personal transaction within the meaning of the Prevention of Financial Markets Abuse Act, 2005;
    - ii. it involves the misuse or improper disclosure of confidential information;
    - iii. it conflicts or is likely to conflict with an obligation of the Licence Holder under the UCITS Directive, the Act, the regulations issued thereunder and any applicable Investment Services Rules;
  - b. advising or procuring, other than in the proper course of his employment or contract for services, any other person to enter into a transaction in financial instruments which, if a personal transaction of the relevant person, would be covered by paragraph (a) or by the Investment Services Rules or would otherwise constitute a misuse of information relating to pending orders;
  - c. disclosing, other than in the normal course of his employment or contract for services and without prejudice to article 6(2) of the Prevention of Financial Markets Abuse Act 2005, any information or opinion to any other person if the relevant person knows, or reasonably ought to know, that as a result of that disclosure that other person will or would be likely to take either of the following steps:
    - i. to enter into a transaction in financial instruments which, where a personal transaction of the relevant person would be covered by paragraph (a), by the Investment Services Rules or would otherwise constitute a misuse of information relating to pending orders;
    - ii. to advise or procure another person to enter into such a transaction.
- 2.43 The arrangements required under SLC 2.42 shall in particular be designed to ensure that:
- a. each relevant person covered by SLC 2.42 is aware of the restrictions on personal transactions, and of the measures established by the Licence Holder in connection with personal transactions and disclosure, in accordance with SLC 2.42;
  - b. the Licence Holder is informed promptly of any personal transaction entered into by a relevant person, either by notification of that transaction or by other procedures enabling the Licence Holder to identify such transactions;

- c. a record is kept of the personal transaction notified to the Licence Holder or identified by it, including any authorisation or prohibition in connection with such a transaction.
- 2.44 For the purposes of SLC 2.43(b), where certain activities are performed by third parties, the Licence Holder shall ensure that the entity performing the activity maintains a record of personal transactions entered into by any relevant person and provides that information to the Licence Holder promptly on request.
- 2.45 The requirements prescribed in SLCs 2.42 to 2.44 shall not apply to the following:
- a. personal transactions effected under a discretionary portfolio management service where there is no prior communication in connection with the transaction between the portfolio manager and the relevant person or other person for whose account the transaction is executed;
  - b. personal transactions in UCITS or units in collective undertakings that are subject to supervision under a law which requires an equivalent level of risk spreading in their assets, where the relevant person and any other person for whose account the transactions are effected are not involved in the management of that undertaking.

### **Recording of Portfolio Transactions**

- 2.46 The Licence Holder shall ensure, for each portfolio transaction relating to UCITS, that a record of information which is sufficient to reconstruct the details of the order and the executed transaction is produced without delay. Such record shall include:
- a. the name or other designation of the UCITS and of the person acting on account of the UCITS;
  - b. the details necessary to identify the instrument in question;
  - c. the quantity;
  - d. the type of the order or transaction;
  - e. the price;
  - f. for orders, the date and exact time of the transmission of the order and name or other designation of the person to whom the order was transmitted, or for transactions, the date and exact time of the decision to deal and execution of the transaction;
  - g. the name of the person transmitting the order or executing the transaction;

- h. where applicable, the reasons for the revocation of an order;
- i. for executed transactions, the counterparty and execution venue identification.

For the purposes of paragraph (i), an “execution venue” shall mean a regulated market, a multilateral trading facility, a systematic internaliser or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing.

### **Recording of Subscription and Redemption Orders**

- 2.47 The Licence Holder shall take all reasonable steps to ensure that the received UCITS subscription and redemption orders are centralised and recorded immediately after receipt of any such order.
- 2.48 The records referred to in SLC 2.47 shall include information on the following:
- a. the relevant UCITS;
  - b. the person giving or transmitting the order;
  - c. the person receiving the order;
  - d. the date and time of the order;
  - e. the terms and means of payment;
  - f. the type of the order;
  - g. the date of execution of the order;
  - h. the number of units subscribed or redeemed;
  - i. the subscription or redemption price for each unit;
  - j. the total subscription or redemption value of the units;
  - k. the gross value of the order including charges for subscription or net amount after charges for redemption.

### **Recordkeeping Requirements**

- 2.49 The Licence Holder shall retain the records referred to in SLCs 2.43(c), 2.46 to 2.48 for a period of at least 5 years. However in exceptional circumstances, the MFSA may require the Licence Holder to retain any or all of those records for a longer period,

determined by the nature of the instrument or portfolio transaction, where it is necessary to enable the competent authority to exercise its regulatory and supervisory functions under the Act and any applicable regulations or Investment Services Rules issued thereunder.

- 2.50 Where the Licence Holder's licence has been cancelled or revoked prior to the expiration of the aforementioned 5-year period, the MFSA may require such Licence Holder to retain the records referred to in SLC 2.49 for the outstanding term of such 5-year period.
- 2.51 Where the Licence Holder transfers its responsibilities in relation to the UCITS to another Licence Holder or to a European Management Company, the MFSA or European authority of the European Management Company home Member State or EEA State may require that arrangements are made for the records referred to in SLC 2.49 to be accessible to the Maltese Licence Holder or European Management Company to which the responsibilities in relation to the UCITS have been transferred.
- 2.52 The records shall be retained in a medium that allows the storage of information in a way accessible for future reference by the MFSA, and in such form and manner that the following conditions are met:
- a. the MFSA must be able to access them readily and to reconstitute each key stage of the processing of each portfolio transaction;
  - b. it must be possible for any corrections or other amendments, and the contents of the records prior to such corrections or amendments, to be easily ascertained;
  - c. it must not be possible for the records to be otherwise manipulated or altered.

## **Enforcement**

- 2.53 The Licence Holder shall at all times observe the Licence Conditions which are applicable to it, as well as the relative requirements which emanate from the Act and regulations issued thereunder. In terms of the Act, the MFSA has various sanctioning powers which may be used against the Licence Holder which does not comply with its regulatory obligations. Such powers include the right to impose administrative penalties in terms of Article 16A of the Act.

**3 Conduct of Business**

3.01 The Licence Holder shall be expected to comply with the conduct of business rules prescribed hereunder. In particular the Licence Holder shall:

- a. act honestly and fairly in conducting its business activities in the best interests of the UCITS it manages and the integrity of the market;
- b. act with due skill, care and diligence, in the best interests of the UCITS it manages and the integrity of the market;
- c. have and employ effectively the resources and procedures that are necessary for the proper performance of its business activities;
- d. avoid conflicts of interest and when they cannot be avoided, ensure that the UCITS managed are fairly treated;
- e. comply with all regulatory requirements applicable to the conduct of its business activities so as to promote the best interests of its investors and the integrity of the market.

In accordance with SLC 1.02, if a licenced entity is providing the following additional services: [i] management of portfolio of investments and/or [ii] investment advice concerning one or more of the instruments listed in the Act, the concerned Licence Holder is expected to take into account the Guidelines as issued by ESMA on certain aspects of the MiFID suitability requirements. These Guidelines may be downloaded from ESMA’s website: [https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387\\_en.pdf](https://www.esma.europa.eu/sites/default/files/library/2015/11/2012-387_en.pdf)

**Criteria for the identification of conflicts of interest**

3.02 For the purposes of identifying the types of conflict of interest that arise in the course of providing services and activities and whose existence may damage the interests of a UCITS, the Licence Holder shall take into account, by way of minimum criteria, the question of whether it, or a relevant person, or a person directly or indirectly linked by way of control to the Licence Holder, is in 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 UCITS;
- b. the Licence Holder, or that person has an interest in the outcome of a service or activity provided to the UCITS or another client or of a transaction carried out on behalf of the UCITS or another client, which is distinct from the UCITS interest in that outcome;

- c. the Licence Holder or that person has a financial or other incentive to favour the interest of another client or group of clients over the interests of the UCITS;
  - d. the Licence Holder, or that person carries on the same activities for the UCITS and for another client or clients which are not UCITS;
  - e. the Licence Holder or that person receives or will receive from a person other than the UCITS, an inducement in relation to collective portfolio management activities provided to the UCITS, in the form of monies, goods or services other than the standard commission or fee for that service.
- 3.03 When identifying the types of conflict of interest, the Licence Holder shall take into account:
- a. the interests of the Licence Holder, including those deriving from its belonging to a group or from the performance of services and activities, the interests of the clients and the duty of the Licence Holder towards the UCITS;
  - b. the interests of two or more managed UCITS.

## **Conflicts of Interest Policy**

- 3.04 The Licence Holder shall establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organisation of the Licence Holder and the nature, scale and complexity of its business.
- 3.05 Where the Licence Holder is a member of a group, the conflicts of interest policy shall also take into account any circumstances of which the company is or should be aware which may give rise to a conflict of interest resulting from the structure and business activities of other members of the group.
- 3.06 The conflicts of interest policy established in accordance with SLC 3.04 to 3.05 shall include the following content:
- a. with reference to collective portfolio management activities carried out by or on behalf of the Licence Holder, the identification of the circumstances which constitute or may give rise to a conflict of interest entailing a material risk of damage to the interests of the UCITS or one or more other clients;
  - b. procedures to be followed and measures to be adopted to manage such conflicts.

## **Independence in Conflicts Management**

- 3.07 The Licence Holder shall ensure that the procedures and measures provided for in SLC 3.06 (b) are designed to ensure that the relevant persons engaged in different business activities involving a conflict of interest carry on those activities at a level of independence appropriate to the size and activities of the Licence Holder and of the group to which it belongs and to the materiality of the risk of damage to the interests of clients.
- 3.08 The procedures to be followed and measures to be adopted in accordance with SLC 3.06 (b) shall, where necessary and appropriate for the Licence Holder to ensure the requisite degree of independence, include the following:
- a. effective procedures to prevent or control the exchange of information between relevant persons engaged in collective portfolio management activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;
  - b. the separate supervision of relevant persons whose principal functions involve carrying out collective portfolio management activities on behalf of, or providing services to, clients or to investors whose interests may conflict, or who otherwise represent different interests that may conflict, including those of a Licence Holder;
  - c. 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;
  - d. measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out collective portfolio management activities;
  - e. measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate collective portfolio management activities where such involvement may impair the proper management of conflicts of interest.
- 3.09 Where the adoption or the practice of one or more of the aforementioned measures and procedures does not ensure the requisite degree of independence, the Licence Holder will adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

### **Management of Activities Giving Rise to Detrimental Conflict of Interest**

- 3.10 The Licence Holder shall keep and regularly update a record of the types of collective portfolio management activities undertaken by or on behalf of a UCITS Management Company in which a conflict of interest entailing a material risk of damage to the

interests of one or more UCITS or other clients has arisen or, in the case of an ongoing collective portfolio management activity, may arise.

- 3.11 Where the organisational or administrative arrangements made by the Licence Holder for the management of conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to the interests of UCITS or of its unit-holders will be prevented, the senior management or other competent internal body of the Licence Holder shall be promptly informed. Such senior management or other competent internal body shall take any decision necessary to ensure that in any case the Licence Holder acts in the best interests of the UCITS and of its unit-holders.
- 3.12 The Licence Holder shall report the situations referred to in SLC 3.11 to investors by any appropriate durable medium and give reasons for its decision.

### **Strategies for the Exercise of Voting Rights**

- 3.13 The Licence Holder shall develop adequate and effective strategies for determining when and how voting rights attached to instruments held in the managed portfolios are to be exercised, to the exclusive benefit of the UCITS concerned. A summary description of such strategies shall be made available to investors.
- 3.14 The strategy referred to in SLC 3.13 shall determine measures and procedures for:
- a. monitoring relevant corporate events;
  - b. ensuring that the exercise of voting rights is in accordance with the investment objectives and policy of the relevant UCITS;
  - c. preventing or managing any conflicts of interest arising from the exercise of voting rights.
- 3.15 Details of the actions taken on the basis of the strategies referred to in SLC 3.13 and 3.14 shall be made available to unit-holders free of charge upon request.

### **Duty to Act in the Best Interests of UCITS and their Unit-Holders**

- 3.16 The Licence Holder shall ensure that unit-holders are treated fairly, and shall refrain from placing the interests of any group of unit-holders above the interests of any other group of unit-holders.
- 3.17 The Licence Holder shall apply appropriate policies and procedures for preventing malpractices that might reasonably be expected to affect the stability and integrity of the market.
- 3.18 The Licence Holder shall ensure that fair, correct and transparent pricing models and valuation systems are used for the UCITS it manages, in order to comply with the

duty to act in the best interests of the unit-holders. The Licence Holder must be able to demonstrate that the UCITS portfolios have been accurately valued.

- 3.19 The Licence Holder shall act in such a way as to prevent undue costs being charged to the UCITS and its unit-holders.

### **Due Diligence Requirements**

- 3.20 The Licence Holder shall be required to ensure a high level of diligence in the selection and ongoing monitoring of investments, in the best interests of UCITS and the integrity of the market.
- 3.21 The Licence Holder shall ensure it has adequate knowledge and understanding of the assets in which the UCITS are invested.
- 3.22 The Licence Holder shall establish written policies and procedures on due diligence and implement effective arrangements for ensuring that investment decisions on behalf of the UCITS are carried out in compliance with the objectives, investment strategy and risk limits of the UCITS.
- 3.23 When implementing its risk management policy and where it is appropriate after taking into account the nature of a foreseen investment, the Licence Holder shall formulate forecasts and perform analyses concerning the investment's contribution to the UCITS portfolio composition, liquidity and risk and reward profile before carrying out the investment. The analysis must only be carried out on the basis of reliable and up-to-date information, both in quantitative and qualitative terms.
- 3.24 The Licence Holder shall exercise due skill, care and diligence when entering into, managing or terminating any arrangements with third parties in relation to the performance of risk management activities. Before entering into such arrangements, the Licence Holder shall take the necessary steps in order to verify that the third party has the ability and capacity to perform the risk management activities reliably, professionally and effectively. The Licence Holder shall establish methods for the ongoing assessment of the standard of performance of the third party.

### **Handling of Subscription and Redemption Orders - Reporting Obligations in Respect of Execution of Subscription and Redemption Orders**

- 3.25 Where the Licence Holder has carried out a subscription or redemption order from a unit-holder, it shall notify the unit-holder, by means of a durable medium, confirming execution of the order as soon as possible, and no later than the first business day following execution or, where the confirmation is received by the Licence Holder from a third party, no later than the first business day following receipt of the confirmation from the third party.

- 3.26 SLC 3.25 shall not apply where the notice to the unit-holder would contain the same information as a confirmation that is to be promptly dispatched to the unit-holder by another person.
- 3.27 The notice referred to in SLC 3.25 shall, where applicable, include the following information:
- a. the identification of the Licence Holder;
  - b. the name or other designation of the unit-holder;
  - c. the date and time of receipt of the order and method of payment;
  - d. the date of execution;
  - e. the UCITS identification;
  - f. the nature of the order (subscription or redemption);
  - g. the number of units involved;
  - h. the unit value at which the units were subscribed or redeemed;
  - i. the reference value date;
  - j. the gross value of the order including charges for subscription or net amount after charges for redemptions;
  - k. a total sum of the commissions and expenses charged and, where the investor so requests, an itemised breakdown.
- 3.28 Where orders for a unit-holder are executed periodically, the Licence Holder shall either take the action specified in SLCs 3.25 and 3.26 or provide the unit-holder, at least once every 6 months, with the information listed in SLC 3.27 in respect of those transactions.
- 3.29 The Licence Holder shall provide the unit-holder, upon request, with information about the status of the order.

### **Best Execution - Executions of Decisions to Deal on Behalf of the Managed UCITS**

- 3.30 The Licence Holder shall act in the best interests of the UCITS it manages when executing decisions to deal on behalf of the managed UCITS in the context of the management of its portfolios.

- 3.31 For the purposes of SLC 3.30, the Licence Holder shall take all reasonable steps to obtain the best possible result for the UCITS, taking into account price, costs, speed, likelihood of execution and settlement, order size and nature, or any other consideration relevant to the execution of the order. The relative importance of such factors shall be determined by reference to the following criteria:
- a. the objectives, investment policy and risks specific to the UCITS, as indicated in the prospectus or as the case may be in the fund rules or articles of association of the UCITS;
  - b. the characteristics of the order;
  - c. the characteristics of the financial instruments that are the subject of that order;
  - d. the characteristics of the execution venues to which that order can be directed.
- 3.32 The Licence Holder shall establish and implement effective arrangements for complying with the obligation referred to in SLC 3.31. In particular, the Licence Holder shall establish and implement a policy to allow it to obtain the best possible result for UCITS orders in accordance with SLC 3.31.
- 3.33 The Licence Holder shall obtain the prior consent of the UCITS on the execution policy. The Licence Holder shall make available appropriate information to unit-holders on the execution policy and on any material changes to their policy.
- 3.34 The Licence Holder shall monitor on a regular basis the effectiveness of its arrangements and policy for the execution of orders in order to identify and, where appropriate, correct any deficiencies.
- 3.35 The Licence Holder shall review the execution policy on an annual basis, and whenever a material change occurs that affects the Licence Holder's ability to continue to obtain the best possible result for the managed UCITS.
- 3.36 The Licence Holder shall be able to demonstrate that it has executed orders on behalf of the UCITS in accordance with the management company's execution policy.

### **Placing Orders to Deal on Behalf of UCITS with Other Entities for Execution**

- 3.37 The Licence Holder shall act in the best interests of the UCITS it manages when placing orders to deal on behalf of the managed UCITS with other entities for execution, in the context of the management of their portfolios.
- 3.38 The Licence Holder shall take all reasonable steps to obtain the best possible result for the UCITS taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the

order. The relative importance of such factors shall be determined by reference to SLC 3.31.

- 3.39 For the purposes referred to in SLC 3.38, the Licence Holder shall establish and implement a policy to enable it to comply with the obligation prescribed in SLC 3.38. Such policy shall identify, in respect of each class of instruments, the entities with which the orders may be placed. The Licence Holder shall only enter into arrangements for execution where such arrangements are consistent with obligations laid down in SLCs 3.37 to 3.42. The Licence Holder shall make available to unit-holders appropriate information on the policy established in accordance with SLC 3.38 and on any material changes to such policy.
- 3.40 The Licence Holder shall monitor on a regular basis the effectiveness of the policy established in accordance with SLC 3.38 and 3.39 and, in particular, the execution quality of the entities identified in that policy and, where appropriate, correct any deficiencies.
- 3.41 The Licence Holder shall review the said policy on an annual basis. Such review shall also be carried out whenever a material change occurs that affects the Licence Holder's ability to continue to obtain the best possible result for the managed UCITS.
- 3.42 The Licence Holder shall be able to demonstrate that it has placed orders on behalf of the UCITS in accordance with the policy established in terms of SLC3.38 and 3.39.

### **General Principles on Handling of Orders**

- 3.43 The Licence Holder shall establish and implement procedures and arrangements which provide for the prompt, fair and expeditious execution of portfolio transactions on behalf of the UCITS. Such procedures and arrangements shall satisfy the following conditions:
- a. ensure that orders executed on behalf of UCITS are promptly and accurately recorded and allocated;
  - b. execute otherwise comparable UCITS orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make this impracticable, or the interests of the UCITS require otherwise;

Financial instruments or sums of money, received in settlement of the executed orders shall be promptly and correctly delivered to the account of the appropriate UCITS.

- 3.44 The Licence Holder shall not misuse information relating to pending UCITS orders, and shall take all reasonable steps to prevent the misuse of such information by any of its relevant persons.

## Aggregation and Allocation of Trading Orders

- 3.45 The Licence Holder shall not carry out a UCITS order in aggregate with an order of another UCITS or another client or with an order on its own account, unless the following conditions are met:
- a. it is unlikely that the aggregation of orders will work overall to the disadvantage of any UCITS or clients whose order is to be aggregated;
  - b. an order allocation policy has been established and implemented, providing in sufficiently precise terms for the fair allocation of aggregated orders, including how the volume and price of orders determines allocations and the treatment of partial executions.
- 3.46 Where the Licence Holder aggregates a UCITS order with one or more orders of other UCITS or clients and the aggregated order is partially executed, it shall be required to allocate the related trades in accordance with its order allocation policy.
- 3.47 The Licence Holder that has aggregated transactions for own account with one or more UCITS or other clients' orders, shall not allocate the related trades in a way that is detrimental to the UCITS or another client.
- 3.48 Where the Licence Holder aggregates an order of a UCITS or another client with a transaction for own account and the aggregated order is partially executed, the Licence Holder shall allocate the related trades to the UCITS or other client in priority over those for own account.
- 3.49 Where the Licence Holder is able to demonstrate to the UCITS or its other client on reasonable grounds that it would not have been able to carry out the order on such advantageous terms without aggregation, or at all, it may allocate the transaction for own account proportionally, in accordance with the policy referred to in SLC 3.45 (b).

## Safeguarding the Best Interests of UCITS in Inducements

- 3.50 The Licence Holder shall not be regarded as acting honestly, fairly and professionally in accordance with the best interests of the UCITS if, in relation to the activities of investment management and administration to the UCITS, it pays or is paid any fee or commission, or provides or is provided with any non-monetary benefit, other than the following:
- a. a fee, commission or non-monetary benefit paid or provided to or by the UCITS or a person on behalf of the UCITS;
  - b. a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, where the following conditions are satisfied:

- i. the existence, nature and amount of the fee, commission or benefit, or, where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the UCITS in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant service;
  - ii. the payment of the fee or commission, or the provision of the non-monetary benefit must be designed to enhance the quality of the relevant service and not impair compliance with the duty of the Licence Holder to act in the best interests of the UCITS;
- c. proper fees which enable or are necessary for the provision of the relevant service, including custody costs, settlement and exchange fees, regulatory levies or legal fees, and which, by their nature, cannot give rise to conflicts with the Licence Holder's duties to act honestly, fairly and professionally in accordance with the best interests of the UCITS.
- 3.51 For the purposes of SLC 3.50(b)(i), the Licence Holder shall disclose the essential terms of the arrangements relating to the fee, commission or non-monetary benefit in summary form, provided that it undertakes to disclose further details at the request of the unit-holder and provided that it honours that undertaking.

### **Remuneration Policies and Practices**

- 3.52 The Licence Holder shall establish and apply remuneration policies and practices that are consistent with, and promote sound and effective risk management and that neither encourage risk taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the UCITS that it manages nor impair compliance with the Licence Holders' duty to act in the best interests of the UCITS.
- 3.53 The remuneration policies and practices shall include fixed and variable components and salaries and discretionary pension benefits.
- 3.54 The remuneration policies and practices shall apply to those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls within the remuneration bracket of senior management and risk takers whose professional activities have a material impact on the risk profiles of the Licence Holder or of the UCITS it manages.
- 3.55 The Licence Holder shall further refer to and comply with the provisions of the ESMA Guidelines on sound remuneration policies and practices under the UCITS Directive and the AIFMD and the Guidance Notes on the application of the proportionality principle issued by the Authority.

3.56 When establishing and applying the remuneration policies referred to in SLCs 3.52 to 3.55, the Licence Holder shall comply with the following principles in a ways and to the extent that is appropriate to their size, internal organisation and the nature, scope and complexity of their activities:

- (a) the remuneration policy is consistent with and promotes sound and effective risk management and does not encourage risk taking which is inconsistent with the risk profiles, rules or instruments of incorporation of the UCITS that the Licence Holder manages;
- (b) the remuneration policy is in line with the business strategy, objectives, values and interests of the Licence Holder and the UCITS that it manages and of the investors in such UCITS, and includes measures to avoid conflicts of interest;
- (c) the remuneration policy is adopted by the management body of the Licence Holder in its supervisory function, and that body adopts, and reviews at least annually, the general principles of the remuneration policy and is responsible for, and oversees their implementation:

Provided that the tasks referred to in (c) shall be undertaken only by the members of the management body who do not perform any executive functions in the Licence Holder and who have expertise in risk management and remuneration;

- (d) the implementation of the remuneration policy is, at least annually, subject to central and independent internal review for compliance with policies and procedures for remuneration adopted by the management body in its supervisory function;
- (e) staff engaged in control functions are compensated in accordance with the achievement of the objectives linked to their functions, independently of the performance of the business areas that they control;
- (f) the remuneration of the senior officers in the risk management and compliance functions is overseen directly by the remuneration committee, where such a committee exists;
- (g) where remuneration is performance-related, the total amount of remuneration is based on a combination of the assessment as to the performance of the individual and of the business unit or UCITS concerned and as to their risks and of the overall results of the Licence Holder when assessing individual performance, taking into account financial and non-financial criteria;

- (h) the assessment of performance is set in a multi-year framework appropriate to the holding period recommended to the investors of the UCITS managed by the Licence Holder in order to ensure that the assessment process is based on the longer-term performance of the UCITS and its investment risks and that the actual payment of performance based components of remuneration is spread over the same period;
- (i) guaranteed variable remuneration is exceptional, occurs only in the context of hiring new staff and is limited to the first year of engagement;
- (j) fixed and variable components of total remuneration are appropriately balanced and the fixed component represents a sufficiently high proportion of the total remuneration to allow the operation of a fully flexible policy on variable remuneration components, including the possibility to pay no variable remuneration component;
- (k) payments relating to the early termination of a contract reflect performance achieved over time and are designed in a way that does not reward failure;
- (l) the measurement of performance used to calculate variable remuneration components or pools of variable remuneration components includes a comprehensive adjustment mechanism to integrate all relevant types of current and future risks;
- (m) subject to the legal structure of the UCITS and its fund rules or instruments of incorporation, a substantial portion, and in any event at least 50% of any variable remuneration component consists of units of the UCITS concerned, equivalent ownership interests, or share-linked instruments or equivalent non-cash instruments with equally effective incentives as any of the instruments referred to in this paragraph, unless the management of the UCITS accounts for less than 50% of the total portfolio managed by the Licence Holder, in which case the minimum of 50 % does not apply:

Provided that the instruments referred to in this paragraph shall be subject to an appropriate retention policy designed to align incentives with the interests of the Licence Holder and the UCITS that it manages and the investors of such UCITS;

Provided further that the MFSA may place restrictions on the types and designs of those instruments or ban certain instruments as appropriate;

Paragraph (m) shall apply to both the portion of the variable remuneration component deferred in line with paragraph (n) and the portion of the variable remuneration component not deferred;

- (n) a substantial portion, and in any event at least 40% of the variable remuneration component, is deferred over a period of at least three years, which is appropriate in view of the holding period recommended to the investors of the UCITS concerned and is correctly aligned with the nature of the risks of the UCITS in question:

Provided that remuneration payable under deferral arrangements vests no faster than on a pro-rata basis; in the case of a variable remuneration component of a particularly high amount, at least 60% of the amount shall be deferred.

- (o) the variable remuneration, including the deferred portion, is paid or vests only if it is sustainable according to the financial situation of the Licence Holder as a whole, and justified according to the performance of the business unit, the UCITS and the individual concerned:

Provided that the total variable remuneration shall generally be considerably contracted where subdued or negative financial performance of the Licence Holder or of the UCITS concerned occurs, taking into account both current compensation and reductions in payouts of amounts previously earned, including through malus or clawback arrangements.

- (p) the pension policy is in line with the business strategy, objectives, values and long-term interests of the Licence Holder and the UCITS that it manages:

Provided that if the employee terminates employment with the Licence Holder before retirement, discretionary pension benefits shall be held by the Licence Holder for a period of five years in the form of instruments referred to in paragraph (m). In the case of an employee reaching retirement, discretionary pension benefits shall be paid to the employee in the form of instruments referred to in paragraph (m) subject to a five-year retention period;

- (q) staff are required to undertake not to use personal hedging strategies or remuneration- and liability-related insurance to undermine the risk alignment effects embedded in their remuneration arrangements;

- (r) variable remuneration is not paid their vehicles or methods that facilitate the avoidance of the requirements prescribed in these Rules.

- 3.57 The principles outlined in SLC 3.56 shall apply to any benefit of any type paid by the Licence Holder, to any amount paid directly by the UCITS itself, including performance fees, and to any transfer of units or shares of the UCITS, made for the benefit of those categories of staff, including senior management, risk takers, control functions and any employee receiving total remuneration that falls into the remuneration bracket of senior management and risk takers, whose professional activities have a material impact on their risk profile or the risk profile of the UCITS that they manage.

- 3.58 A Licence Holder that is significant in terms of its size or of the size of the UCITS it manages, its internal organisation and the nature scope and complexity of its activities shall establish a remuneration committee. The remuneration committee shall be constituted in a way that enables it to exercise competent and independent judgement on remuneration policies and practices and the incentives created for managing risk.
- 3.59 The remuneration committee that is, where appropriate, established in accordance with the ESMA Guidelines referred to in SLC 3.55 shall be responsible for the preparation of decisions regarding remuneration, including those which have implications for the risk and risk management of the Licence Holder or the UCITS concerned and which are to be taken by the management body in its supervisory function. The remuneration committee shall be chaired by a member of the management body who does not perform any executive functions in the Licence Holder concerned. The members of the remuneration committee shall be members of the management body who do not perform any executive functions in the Licence Holder concerned.
- 3.60 If employee representation on the management body is provided for by Maltese law, the remuneration committee shall include one or more employee representatives. When preparing its decisions, the remuneration committee shall take into account the long-term interest of investors and other stakeholders and the public interest.

## 4 Outsourcing

- 4.01 Where the Licence Holder delegates to third parties, for the purpose of a more efficient conduct of its business, the carrying out on its behalf of one or more of its functions, the Licence Holder shall comply with the following requirements:
- a. the Licence Holder shall submit to the MFSA the details of such delegation in an appropriate manner and shall obtain the MFSA's prior written consent;
  - b. such delegation shall not prevent the effectiveness of supervision over the Licence Holder and in particular shall not prevent the Licence Holder from acting, or the UCITS from being managed in the best interests of the investors;
  - c. the Licence Holder shall have measures in place that enable the persons who conduct its business to monitor effectively, at any time, the activities of the undertaking to which functions are delegated;
  - d. such delegation shall not prevent the persons who conduct the business of the Licence Holder from giving further instructions to the undertaking to which functions are delegated at any time or from withdrawing such delegation with immediate effect when this is in the interest of investors;
  - e. the undertaking to which functions are delegated shall be qualified and capable of undertaking the functions being delegated;
  - f. the UCITS' prospectus shall list the functions being delegated in the form and manner specified in the Investment Services Rules for Retail Collective Investment Schemes.
- 4.02 Where a delegation in accordance with SLC 4.01 is made in respect of the function of investment management, such delegation shall only be given to undertakings authorised or licenced to provide asset management services and subject to prudential supervision. Such delegation shall be in accordance with investment-allocation criteria periodically laid down by the Licence Holder.
- 4.03 A delegation of the core function of investment management shall not be made to the custodian or to any other undertaking whose interests may conflict with those of the Licence Holder or of the unit-holders.
- 4.04 Where a delegation in accordance with SLC 4.01 is made in respect of the function of investment management to an undertaking licensed in a third country, co-operation between the competent authority and the supervisory authority of such third country shall be ensured.

- 4.05 The liability of the Licence Holder shall not be affected by delegation of any functions to third parties. The Licence Holder shall not delegate its functions to the extent that it becomes a letter-box entity.

## 5 Financial Resources

5.01 The Licence Holder shall at all times have financial resources sufficient for the proper performance of its functions. The financial resources of the Licence Holder shall at all times exceed the level prescribed hereunder. The Licence Holder shall maintain own funds equal to or in excess of its capital resources requirement. This shall constitute the Licence Holder's financial resources requirement.

5.02 Without prejudice to the generality of SLC 5.01, the Licence Holder must have own funds which are equivalent to an initial capital of at least EUR 125,000 taking into account the following:

- a. when the value of the portfolios of the Licence Holder exceeds EUR 250,000,000, the Licence Holder will be required to provide an additional amount of own funds which is equal to 0.02% of the amount by which the value of the portfolios of the Licence Holder exceeds EUR 250,000,000.

Provided that the total initial capital and the additional amount of own funds shall not exceed EUR 10,000,000.

- b. For the purposes of paragraph (a) above, the following portfolios shall be deemed to be the portfolios of the Licence Holder:
  - i. unit trusts/ common funds managed by the Licence Holder including portfolios for which it has delegated the management function but excluding portfolios that it is managing under delegation;
  - ii. investment companies for which the Licence Holder is the designated management company;
  - iii. other collective investment schemes managed by the Licence Holder including portfolios for which it has delegated the management function but excluding portfolios that it is managing under delegation;
- c. Without prejudice to the amounts prescribed in paragraphs (a) and (b) above, the own funds of the Licence Holder must at no time be less than one quarter of the fixed overheads requirement in terms of Section 4.3 of Appendix I.

5.03 For the purposes of SLC 5.02(a), (b) and (c) above, the MFSA may authorise the Licence Holder not to provide up to 50% of the additional amount of own funds referred to in SLC 5.02(a) if it benefits from a guarantee of the same amount given by a credit institution or an insurance undertaking. The credit institutions or insurance undertaking must have its registered office in Malta or in any other recognised jurisdiction where it is subject to prudential rules considered by the MFSA to be equivalent to those in force.

- 5.04 The meaning of own funds applicable to the Licence Holder, are set out in Section 4.1.1 to 4.1.4 of Appendix 1.
- 5.05 The Licence Holder shall comply with any further financial resources requirements set by the MFSA. If the MFSA so determines, the Licence Holder will be given due notice in writing of the additional financial resources requirements which shall be applied.
- 5.06 The Licence Holder shall immediately advise the MFSA if at any time it is in breach of its Financial Resources Requirement. In this case, the MFSA may, if the circumstances justify it, allow the Licence Holder a limited period within which to restore its financial resources to the required level.

### **Professional Indemnity Insurance Requirement**

- 5.07 The Licence Holder shall take out and maintain such insurance cover as it considers appropriate. The Licence Holder shall be required to maintain such insurance policies of such classes and types to provide at least the minimum level of protection set out in Section 2 of Appendix 6 of these Rules.

For the purposes of demonstrating to the satisfaction of the MFSA that the above requirement is being complied with on an on-going basis, the Licence Holder shall upon request by the MFSA submit a copy of the renewal cover note or such other written evidence as the MFSA may require to establish compliance with these Rules.

The Licence Holder shall, within two working days from the date it becomes aware of any of the circumstances specified in (a) to (g), inform the MFSA in writing where:

- a. during the currency of a policy, the Licence Holder has notified insurers of an incident which may give rise to a claim under the policy;
- b. during the currency of a policy, the insurer has cancelled the policy or has notified its intention of doing so;
- c. the policy has not been renewed or has been cancelled and another policy satisfying the requirements of Appendix 6 has not been taken out from the day on which the previous policy lapsed or was cancelled;
- d. during the currency of a policy, the terms or conditions are altered in any manner so that the policy no longer satisfies the requirements of Appendix 6;
- e. the insurer has intimated that it intends to decline to indemnify the insured in respect of a claim under the policy;

- f. the insurer has given notice that the policy will not be renewed or will not be renewed in a form which will enable the policy to satisfy the requirements of Appendix 6;
- g. during the currency of a policy, the risks covered by the policy or the conditions or terms relating thereto, are altered in any manner.

## Reporting Requirements

- 5.08 The Licence Holder shall have internal control mechanisms and administrative and accounting procedures which permit the verification of their compliance with these Rules as well as effective procedures for risk assessment and effective control and safeguard arrangements for information processing systems.

The Licence Holder shall in each year prepare an Annual Financial Return in the form set out in Appendix 2B signed by at least two directors or partners or any other persons authorised to sign by way of a Board Resolution. In the latter case, the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

- 5.09 The Annual Financial Return shall be submitted to the MFSA within one month of the Accounting Reference Date. In addition, the Annual Audited Financial Return shall be submitted to the MFSA within four months of the Accounting Reference Date.
- 5.10 Audited annual financial statements prepared in accordance with International Financial Reporting Standards, together with a copy of the auditors' management letter and the auditors' report as required by SLC 5.31 shall be submitted to the MFSA within four months of the Accounting Reference Date.
- 5.11 In addition to the Annual Financial Return and audited financial statements, the Licence Holder shall prepare an Interim Financial Return, in the form set out in Appendix 2, at dates three, six and nine months after the Accounting Reference Date. The first Interim Financial Return should cover the three months immediately following the Accounting Reference Date, the second Interim Financial Return should cover the six months immediately following the Accounting Reference Date and the third Interim Financial Return should cover the nine months immediately following the Accounting Reference Date. In the event of a change to the Accounting Reference Date, the dates for the preparation of the Interim Financial Returns shall be agreed with MFSA.
- 5.12 The Interim Financial Return shall be submitted to the MFSA within one month of the date up to which it has been prepared. It shall be signed by at least two directors or partners or any other persons authorised to sign by way of a Board Resolution. In the latter case, the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

- 5.13 The Licence Holder shall prepare and submit such additional financial returns as the MFSA may require.
- 5.14 The Licence Holder shall be responsible for the correct compilation of the Financial Returns. The nature and content of the financial returns shall be as follows:
- a. they shall be in the form set out in Appendix 2B;
  - b. they shall be in agreement with the underlying accounting records;
  - c. accounting policies shall be consistent with those adopted in the audited annual financial statements and shall be consistently applied. These accounting policies should adequately cater for the following:
    - i. amounts in respect of items representing assets or income may not be offset against amounts in respect of items representing liabilities or expenditure, as the case may be, or vice versa, unless duly authorised by the MFSA;
    - ii. balances representing clients' money and/or assets held/controlled by the Licence Holder must not form part of the Licence Holder's Balance Sheet;
  - d. information to be included in the financial returns shall be prepared in accordance with International Financial Reporting Standards;
  - e. investments shall be included in the balance sheet at valuations arrived at in accordance with the provisions of International Financial Reporting Standards;
  - f. financial returns shall not be misleading as a result of the misrepresentation or omission or miscalculation of any material item;
  - g. where the Annual Financial Return has been submitted before the relevant audited annual financial statements have been produced, it shall be updated to reflect the information in the audited financial statements and submitted to the MFSA together with the audited annual financial statements;
  - h. in the case of an individual or individuals in partnership or association, financial returns shall be prepared to show relevant figures for the Investment Services business exclusively. If required by the MFSA to do so, the individual (or individuals) shall submit, in addition, a statement of personal assets and liabilities.
- 5.15 The Licence Holder shall notify the MFSA immediately upon becoming aware:
- a. that it is in breach of the requirements in respect of financial resources, records, reporting or procedures and controls;

- b. that it will be unable to submit an Annual or Interim Financial Return on the due date.

The notification shall give reasons and shall explain what action is being taken to rectify matters.

5.16 The Licence Holder shall notify the MFSA immediately if:

- a. it is notified that its auditor intends to qualify the audit report;
- b. it becomes aware of actual or intended legal proceedings against it;
- c. it decides to claim on a professional indemnity or other policy relating to its Investment Services Business;
- d. the Licence Holder's counterparties in repurchase and reverse repurchase agreements or securities and commodities-lending and securities and commodities-borrowing transactions default on their obligations.

## **Audit**

5.17 The Licence Holder shall appoint an auditor approved by the MFSA. The Licence Holder shall replace its auditor if requested to do so by the MFSA. The MFSA's consent shall be sought prior to the appointment or replacement of an auditor.

The Licence Holder shall make available to its auditor the information and explanations he needs to discharge his responsibilities as an auditor and in order to meet the MFSA's requirements.

5.18 The Licence Holder shall not appoint an individual as an auditor, nor appoint an audit firm where the individual directly responsible for the audit, or his firm is:

- a. a director, partner, qualifying shareholder, officer, representative or employee of the Licence Holder;
- b. a partner of, or in the employment of, any person in (a) above;
- c. a spouse, civil partner, parent, step-parent, child, step-child or other close relative of any person in (a) above;
- d. a person who is not otherwise independent of the Licence Holder;
- e. a person disqualified by the MFSA from acting as an auditor of a Licence Holder.

For this purpose, an auditor shall not be regarded as an officer or an employee of the Licence Holder solely by reason of being an auditor of that Licence Holder.

- 5.19 The Licence Holder shall obtain from its auditor a signed letter of engagement defining clearly the extent of the auditor's responsibilities and the terms of his appointment. The Licence Holder shall confirm in writing to its auditor its agreement to the terms in the letter of engagement. The auditor shall provide the MFSA with a letter of confirmation in the form set out in Annex II to the Application Form for an Investment Services Licence.
- 5.20 The letter of engagement shall include terms requiring the auditor:
- a. to provide such information or verification to the MFSA as the MFSA may request;
  - b. to afford another auditor all such assistance as he may require;
  - c. to vacate his office if he becomes disqualified to act as auditor for any reason;
  - d. if he resigns, or is removed or not reappointed, to advise the MFSA of that fact and of the reasons for his ceasing to hold office. The auditor shall also be required to advise the MFSA if there are matters he considers should be brought to the attention of the MFSA;
  - e. in accordance with article 18 of the Act, to report immediately to the MFSA any fact or decision of which he becomes aware in his capacity as auditor of the Licence Holder which:
    - i. is likely to lead to a serious qualification or refusal of his audit report on the accounts of the Licence Holder; or
    - ii. constitutes or is likely to constitute a material breach of the legal and regulatory requirements applicable to the Licence Holder in or under the Act; or
    - iii. gravely impairs the ability of the Licence Holder to continue as a going concern; or
    - iv. relates to any other matter which has been prescribed.
  - f. in accordance with Article 18 of the Act, to report to the MFSA any facts or decision as specified in (e) above of any person having close links, as defined in Appendix 9, with the Licence Holder, of which the auditor becomes aware in his capacity as auditor of the Licence Holder or of the person having such close links.

- 5.21 If at any time the Licence Holder fails to have an auditor in office for a period exceeding four weeks, the MFSA shall be entitled to appoint a person to fill the vacancy; the fees and charges so incurred being payable by the Licence Holder.
- 5.22 In respect of each annual accounting period, the Licence Holder shall require its auditor to prepare a management letter in accordance with International Standards on Auditing. The auditor must also confirm to the MFSA that the audit has been conducted in accordance with International Standards on Auditing and whether, in the auditor's opinion:
- a. the Annual Financial Return together with the audited annual financial statements are in agreement with the Licence Holder's accounting records;
  - b. the Annual Financial Return has been prepared in accordance with the MFSA's requirements and is consistent with the audited annual financial statements;
  - c. the Financial Resources of the Licence Holder have been properly calculated in accordance with the MFSA's requirements and exceed the Financial Resources Requirement of the Licence Holder as at the Accounting Reference Date;
  - d. proper accounting records have been kept, and adequate systems for their control have been maintained, as required by the MFSA, during the period covered by the Annual Financial Return;
  - e. (i) the Licence Holder has maintained throughout the period covered by the Annual Financial Return, systems adequate to safeguard Customers' Assets and Clients' Money; or  
(ii) based on review procedures performed, nothing has come to the auditor's attention that causes the auditor to believe that the Licence Holder held Customers' Assets or Clients' Money during the period covered by the Annual Financial Return.
  - f. all information and explanations necessary for the purpose of the audit have been obtained.
- 5.23 Where, in the auditor's opinion, one or more of the requirements have not been met, the auditor shall be required to include in his report a statement specifying the relevant requirements and the respects in which they have not been met. Where the auditor is unable to form an opinion as to whether the requirements have been met, the auditor shall be required to specify the relevant requirements and the reasons why he has been unable to form an opinion.
- 5.24 The Licence Holder in receipt of a management letter from its auditor which contains recommendations to remedy any weaknesses identified during the course of the audit, is required to submit to the MFSA by not later than six months from the end of the

financial period to which the management letter relates, a statement setting out in detail the manner in which the auditor's recommendations have been/ are being implemented. In the instance where the Licence Holder has not taken / is not taking any action in respect of any one or more recommendations in the auditor's management letter, the reasons are to be included.

- 5.25 The Licence Holder is required to include in the Directors' Report (which should form part of the annual report to members of the company), a statement regarding breaches of SLCs or other regulatory requirements which occurred during the reporting period, and which were subject to an administrative penalty or other regulatory sanction.

Where there have been no breaches, it is sufficient merely to say so. However if there have been breaches, a summary must be provided of the breach(es) committed and regulatory sanction imposed.

### **Conditions applicable to Licence Holders engaging in foreign currency lending**

- 5.26 The Licence Holder shall, in as far as these may be applicable to any foreign currency lending which it may carry out, abide by the high level principles on foreign currency lending as outlined in [MFSA Rule 1 of 2012](#) on foreign currency lending which is modelled on the Recommendation of the European Systemic Risk Board on lending in foreign currencies (ESRB/2011/1).
- 5.27 Foreign currency lending means lending in any currency other than the legal tender of the country in which the borrower is domiciled. This includes situations where the Euro is the foreign currency due to the borrower's domicile being outside the euro zone.
- 5.28 When the Licence Holder has engaged in any form of foreign currency lending during the period under review, it shall submit a confirmation to this effect together with its Annual Financial Return. Any foreign currency lending activity shall be indicated as a percentage of its total lending. A Licence Holder which has not carried out any foreign currency lending during the period under review is not required to submit a 'nil' return.

- 5.29 When requested to do so by the MFSA, a Licence Holder shall also submit, on the following email address: [statistics@mfsa.com.mt](mailto:statistics@mfsa.com.mt) any statistical returns which may be required under MFSA Rule 1 of 2012 on foreign currency lending.