

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

**The Framework for the Regulation
Of
Investment Services Licence Holders, Regulated
Markets And Central Securities Depositories**

SECURITIES AND MARKETS SUPERVISION UNIT

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**THE FRAMEWORK FOR THE REGULATION OF INVESTMENT SERVICES
LICENCE HOLDERS, REGULATED MARKETS AND CENTRAL SECURITIES
DEPOSITARIES**

SECURITIES AND MARKETS SUPERVISION UNIT

1. BACKGROUND

The MFSA Securities and Markets Supervision Unit is responsible for regulating:

- (i) investment services licence holders [entities which provide services, such as investment advice, in relation to a financial instrument] including fund managers and custodians of collective investment schemes;
- (ii) collective investment schemes [professional and retail];
- (iii) a regulated market [the Malta Stock Exchange];
- (iv) trustees; and
- (v) the central securities depository of the Exchange.

The Unit also supervises the activity of recognised private collective investment schemes and recognised administrators. Lastly, the Unit is also responsible for monitoring trading on the Malta Stock Exchange and investigating any suspicious activity which could be tantamount to market abuse.

2. PURPOSE

The purpose of this document is to outline the manner in which the Authority supervises the activity of Investment Services Licence Holders and the Malta Stock Exchange by providing a general overview of the:

- (i) legislation which falls under the responsibility of the MFSA Securities Unit, this being the Investment Services Act, 1994 [‘ISA’], the Financial Markets Act, 1990 [‘FMA’], the Prevention of Financial Markets Abuse Act, 2005 [‘PFMAA’], Malta’s Anti-Money Laundering and Funding of terrorism Legislation [‘AML’] and the Regulations and Rules made thereunder; and

- (ii) the manner in which the MFSA Securities and Markets Supervision Unit regulates the activity of Investment Services Licence Holders and the Exchange in terms of these Acts.

3. LEGISLATION

The ISA, FMA, PFMAA and AML is the legislation in terms of which the MFSA Securities and Markets Supervision Unit regulates the above-mentioned entities. This legislation is supplemented by Regulations and Rules made thereunder. Regulations are second tier legislation made by the Minister. On the other hand, Rules are third level administrative measures adopted by the MFSA. In addition, the MFSA Securities and Markets Supervision Unit has also issued guidance notes which have the purpose of assisting relevant entities to interpret the provisions of applicable legislation and fulfil their responsibilities in terms of such legislation.

The following is an outline of each of the above-mentioned pieces of legislation and the relative Regulations, Rules and Guidance Notes.

3.1 INVESTMENT SERVICES ACT, 1994

The ISA provides for the authorisation and on-going supervision of investment services licence holders and collective investment schemes operating in or from Malta. The Act also provides for the recognition and supervision of persons who in Malta or from Malta provide to licence holders in Malta, or to equivalent authorised persons and schemes overseas, administrative services which do not themselves constitute licensable activity under the ISA.

The Act gives the MFSA various investigatory and enforcement powers which include the power of imposing administrative sanctions. During 2007, this Act together with the Regulations and third level MFSA Rules [previously referred to as the Investment Services Guidelines and now entitled Investment Services Rules] were amended with the purpose of bringing Maltese law in line with the requirements of the EC Markets in Financial Instruments Directive ['MiFID'], the EC Capital Requirements Directive ['CRD'] and certain aspects of the EC UCITS Directive

['UCITS Directive'] in particular the Implementing Commission Directive 2007/16/EC of 19th March 2007.

A number of Regulations have been made by the Minister under the ISA. These regulations *inter alia* deal with various areas of regulation of securities business such as the safeguarding of customers assets. As part of the transposition of MiFID, five new regulations were issued in 2007. Two of these, one exempting certain service providers from the provisions of the Act and the other stipulating the fees payable to the Authority by ISA licensed and recognised entities, replaced existing regulations.

The MFSA's first set of administrative requirements dealing with securities business was issued in 1995. These rules set licence conditions which lay down detailed conduct of business, prudential, notification and disclosure requirements. The structure and content of the MFSA's third level administrative rules was, during 2007, amended substantially. The standard licence conditions in the Investment Services Guidelines have been divided into four Rule books as follows:

Investment Service Rules for Investment Services Providers: These Rules transpose the Pillar one of the CRD and parts of the MiFID and apply to all investment services licence holders including fund managers and custodians of collective investment schemes. Being Rules which provide for the transposition of MiFID, these Rules also contain standard licence conditions which regulate the activity of multilateral trading facilities ('MTFs') and Systematic Internalisers. These are alternative forms of trading venues provided for by the MiFID. To date, Malta does not have any operators which have been licensed to provide such trading facilities;

Investment Services Rules for Professional Investor Funds ['PIFs']: These Rules apply to Collective Investment Schemes which qualify as professional investor funds and which were licensed after 17th July 2007. All PIFs licensed before that date must come in line with the requirements of these Rules by the 17th July 2008;

Investment Services Rules for Recognised Persons and Retail Collective Investment Schemes: These Rules regulate the activity of recognised fund

administrators, recognised private schemes and existing retail collective investment schemes, including both retail UCITS and Non-UCITS schemes. The standard licence conditions relative to retail collective investment schemes will remain applicable until 23rd July 2008, by which date existing schemes will need to comply with (d) below;

Investment Services Rules for Retail Collective Investment Schemes: These Rules apply to all retail collective investment schemes [both UCITS and NON-UCITS] licensed on or after the 1st November 2007 and will become applicable to **all** such Schemes after the 23rd July 2008. By way of these rules all the provisions of the UCITS Directive, the Commission’s UCITS implementing measure and the applicable third level CESR UCITS guidelines and recommendations have been implemented.

As part of its effort to ensure a proper implementation of MiFID, the MFSA has issued Guidance Notes to the Investment Services Rules for Investment Services Providers. The purpose of these Guidance Notes is to afford Investment Services Licence Holders with best practice guidance on the manner in which they may comply with a number of requirements set out in the MFSA’s Investment Services Rules.

The following table provides an outline of all investment services legislation and guidance notes in terms of which the Securities and Markets Supervision Unit regulates the activity of investment services licence holders:

Table I		
<u>Primary legislation</u>	Investment Services Act, 1994	An Act which regulates the activity of investment services licence holders and collective investment schemes operating in or from Malta. The Act also provides for the recognition and supervision of persons who in Malta or from Malta provide to licence holders in Malta, or to equivalent authorised persons and schemes overseas, administrative services which do not themselves constitute licensable activity under the ISA.
<u>Secondary legislation</u>	Investment Services Act (Control of Assets) Regulations, 1998	These regulations stipulate requirements dealing with the safeguarding of clients assets which Investment Services Licence Holders that hold and control clients’ assets and

		custodians of collective investment schemes must comply with.
	Investment Services Act (Investment Advertisement and Prospectus Exemption) Regulations, 2002	These regulations exempt certain types of prospectuses and investment adverts from the provisions of article 11 of the ISA which article of the Act provides for the regulation of prospectuses of collective investment schemes and investment advertisements issued in or from Malta.
	Investor Compensation Scheme Regulations, 2003	These regulations provide for the establishment and the administration of the activities of an investor compensation scheme. The purpose of such scheme is that of providing compensation to retail investors in the case of the failure of an investment services licence holder. These regulations also have the purpose of transposing the EC Investor Compensation Scheme Directive.
	European Passport Rights for Investment Firms Regulations, 2007	These regulations provide for the passporting, by way of either the freedom to provide services provisions or the establishment of a branch, of: [i] Maltese Investment Firms [Investment Services Licence Holders] into other EEA jurisdictions; and [ii] European Investment Firms [other than Maltese Investment Firms] into Malta. These regulations transpose part of MiFID.
	European Passport Rights for Persons Operating Multilateral Trading Facilities Regulations, 2007	These regulations, which transpose part of MiFID, provide for the passporting of the activities of a multilateral trading facility.
	Investment Services (Tied Agents) Regulations, 2007	These regulations provide for the appointment by investment services licence holders of tied agents and transpose article 23 of MiFID.
	Investment Services Act (Licence and Other Fees) Regulations, 2007	These regulations stipulate the fees which must be paid to the Authority by applicants and entities licensed or recognised under the ISA.
	Investment Services Act (Exemption) Regulations, 2007	These regulations exempt certain service providers and collective investment schemes from the licensing requirement stipulated in articles 3 and 4 of the ISA. A number of articles of these regulations transpose a part of MiFID.

<u>Third Level Rules</u>	Investment Services Rules for Investment Services Providers	These Rules transpose the CRD and parts of the MiFID and apply to all investment services licence holders including fund managers and custodians of collective investment schemes.
Guidance Notes	Guidance Notes to the Investment Services Rules for Investment Services Providers	The purpose of these Guidance Notes is to afford Investment Services Licence Holders with best practice guidance on the manner in which they may comply with a number of requirements set out in the MFSA's Investment Services Rules.

3.2. FINANCIAL MARKETS ACT, 1990

The FMA *inter alia* provides for the authorisation and on-going supervision of regulated markets and central securities depositories [CSDs] operating in or from Malta. The Act grants the Authority the required powers to fulfil its regulatory duties. During 2007, this Act together with the Regulations and third level MFSA Rules [previously referred to as the General Notification Directives applicable to Recognised Investment Exchanges and now titled Financial Market Rules for Regulated Markets] were amended with the aim of transposing and implementing the MiFID and introducing a regime for the regulation of CSDs.

The FMA is supplemented by a number of regulations which deal with the regulation of regulated markets. As part of the transposition of MiFID, seven new regulations were adopted by the Minister. Five of these replaced existing regulations stipulating authorisation, transparency, membership and access requirements and requirements dealing with off-exchange deals and the fees which are due to the Authority from regulated markets operating in or from Malta. The other two regulations provide for: [a] the amendment of the current regulation which provides for delivery versus payment of transactions executed on a regulated market and [b] the passporting within the EEA of the activities of a regulated market. The detailed regulations which specify the requirements which must be satisfied by a Central Securities Depository are still in draft and will be issued later on during 2008.

The third level rules applicable to regulated markets were originally issued by the MFSA in the form of General Notification Directives in 2003, when the Authority took over responsibility for the regulation of investment exchanges. These rules which, since 1st November 2007, have been renamed as Financial Markets Rules, have the purpose of ensuring that due notice of event and specified information is provided to the Authority for the proper fulfilment by the Authority of the regulatory functions prescribed in the Act in relation to regulated markets.

The following table provides an outline of all financial markets legislation dealing with the regulation of regulated markets and CSDs:

Table II		
<u>Primary legislation</u>	Financial Markets Act, 1990	An Act which provides for: [a] the regulation of the activities of regulated markets and central securities depositories operating in or from Malta, and [b] the establishment of a listing authority which authorises the admissibility to listing of financial instruments.
<u>Secondary legislation</u>	Transfer of Listed Securities Regulations, 2004	These regulations create a legal framework which provides for the delivery versus payment of financial instruments which are traded on a regulated market operating in Malta.
	Financial Markets Act (Membership and Access) Regulations, 2007	These regulations, which transpose part of MiFID, stipulate certain requirements dealing with the membership and access to a regulated market by investment services licence holders, other European investment firms, credit institution and other qualifying persons.
	Financial Markets Act (Off-Market Deals) Regulations, 2007	These regulations create a legal framework within which off-market deals, in financial instruments traded on a regulated market authorised in Malta, may be transacted.
	Regulated Markets (Authorisation Requirements) Regulations, 2007	These regulations provide for the requirements which must be satisfied by an applicant if it is to qualify as a regulated market and which must be fulfilled by each regulated market on a continuing and ongoing basis if it is to remain a regulated market. A number of the requirements spelt out in these regulations have the

		purpose of transposing part of MiFID.
	European Rights for Regulated Markets Regulations, 2007	These regulations provide for the passporting of the activities of a regulated market and transpose part of MiFID.
	Regulated Markets (Fees) Regulations, 2007	These regulations stipulate the fees which must be paid to the Authority by applicants and regulated markets.
	Financial Markets Act (Transparency) Regulations, 2007	These regulations provide for various transparency requirements which must be satisfied by a regulated markets and transpose the MiFID transparency requirements.
<u>Third Level Rules</u>	Financial Market Rules for Regulated Markets	These Rules have the purpose of ensuring that due notice of events and specified information is provided to the Authority for the proper fulfilment by the Authority of the regulatory functions prescribed in the Act in relation to regulated markets.

3.3. PREVENTION OF FINANCIAL MARKETS ABUSE ACT, 2005

The PFMAA has the purpose of safeguarding the integrity of Maltese and European Community financial markets and to enhance investor confidence in those markets. To meet this objective, the Act transposes and implements the EC Market Abuse Directive [‘MAD’]. The Act prohibits market abuse and grants the Authority the necessary powers to monitor trading in financial instruments which are traded on the Malta Stock Exchange and investigate suspicious transactions. It also sets certain transparency and disclosure requirements which have the purpose of ensuring that the market is informed about price sensitive information and that the Authority has the required information to fulfil its duties under the said Act.

The Act is complemented by three regulations which have the purpose of setting rules: [a] of disclosure and notification applicable to issuers of financial instruments, persons acting on behalf of issuers of financial instruments, person discharging managerial responsibilities within an issuer financial instruments, and persons

professionally arranging transactions in financial instruments; [b] for the fair presentation of investment recommendations and the disclosure of conflicts of interest; and [c] for the consideration of market practices and manipulative behaviour.

In order to ensure the proper implementation of MAD by the industry, the MFSA has issued Prevention of Financial Market Abuse Guidance notes. The purpose of these Guidance Notes is that of: [a] affording persons affected by the provisions of the PFMAA with some guidance on the meaning of market abuse and the administrative/criminal sanctions which may be applied when a person is found guilty of market abuse; and [b] providing persons affected by the provisions of the PFMAA with direction as to their respective responsibilities and the manner in which they should satisfy certain duties which emanate from the PFMAA regime.

The following table provides an outline of all legislation dealing with the regulation of market abuse:

Table III		
<u>Primary legislation</u>	Prevention of Financial Markets Abuse Act, 2005	The purpose of this Act is to safeguard the integrity of Maltese and Community financial markets and to enhance investor confidence in those markets.
<u>Secondary legislation</u>	Prevention of Financial Market Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations, 2005	These regulations facilitate the application of article 12 of the PFMAA which article stipulates certain duties of journalists, researchers and disseminators of financial recommendations.
	Prevention of Financial Market Abuse (Market Practices and Manipulative Behaviour) Regulations, 2005	These regulations stipulate the factors to be taken into account when considering whether a certain transaction or order to trade amounts to market abuse or may be categorised as an accepted market practice. It further explains the meaning of manipulative behaviour related to false or misleading signals and to price.
	Prevention of Financial Market Abuse (Disclosure and	These regulations stipulate requirements of disclosure and notification applicable to issuers of financial instruments, persons acting on behalf of issuers of financial

	Notification) Regulations, 2005	instruments, person discharging managerial responsibilities within an issuer of financial instruments, and persons professionally arranging transactions in financial instruments.
Guidance Notes	Guidance Notes to the Investment Services Rules for Investment Services Providers	The purpose of these Guidance Notes is to afford persons affected by the provisions of the PFMAA with some guidance on the provisions of the Act and their responsibilities in terms of the said Act.

3.4. PREVENTION OF MONEY LAUNDERING ACT, 1994

Money laundering and the funding of terrorism are a criminal offence in Malta and anti-money laundering and funding of terrorism legislation in Malta puts the onus on different *subject persons* including financial services operators in the area of securities to carry out customer due diligence and report any suspicious transactions to the Financial Intelligence and Analysis Unit [‘FIAU’]. The FIAU, in turn, is responsible to ensure that subject persons comply with the provisions of the AML and any regulations made thereunder. In this regard, it is worthwhile mentioning the Prevention of Money Laundering and Funding of Terrorism Regulations, 2003, which regulations have the purpose of prescribing a number of regulatory requirements with which *subject persons* must comply. In terms of article 27 of the PFLA the FIAU may request any supervisory authority to supervise *subject persons* on its behalf. In this regard, the MFSA Securities and Markets Supervision Unit acts as an agent of the FIAU by monitoring that *subject persons* who carry out securities business are complying with applicable Maltese anti-money laundering and funding of terrorism legislation.

4. MANNER IN WHICH THE SECURITIES AND MARKETS SUPERVISION UNIT FULFILS ITS RESPONSIBILITIES

The MFSA Securities and Markets Supervision Unit’s responsibilities in relation to the regulation of Investment Services Licence Holders, Regulated Markets and Central Securities Depositories consist in compliance monitoring.

4.1 COMPLIANCE MONITORING

The Compliance Monitoring Process has *inter alia* **two basic functions:**

- (a) the supervision of *inter alia* investment services licence holders, regulated markets and central securities depositories [henceforth altogether referred to as ‘authorised persons’] with a view of ensuring that such entities are abiding by the applicable requirements and are therefore fit and proper;
- (b) the monitoring of trading in financial instruments traded on the Malta Stock Exchange and the investigation of suspicious transactions.

4.2.1. Supervision

The MFSA Securities and Markets Supervision Unit supervises authorised persons through:

[a] Off-site supervision: This involves the monitoring of authorised persons through the examination and analysis of the financial and other documentation which they are required to submit periodically to the MFSA in terms of their legal obligations. As part of its off-site supervisory function, the MFSA Securities and Markets Supervision Unit also monitors and reviews media adverts issued by authorised persons and newspaper articles and media coverage dealing with companies which have their financial instruments traded on the Malta Stock Exchange.

[b] On-site supervision: This entails the conduct of compliance visits at the offices of authorised persons. During such visits compliance officials of the MFSA Securities and Markets Supervision Unit verify the extent to which the authorised person is complying with the applicable requirements including the requirements which emanate from the anti-money laundering and funding of terrorism legislation. After the visits a report is drawn up and a letter explaining the finding of the visit is sent to the authorised person.

Where breaches of applicable legislation are identified, the authorised person would be requested to provide the MFSA Securities and Markets Supervision Unit with an explanation of what action it has taken or plans to take in order to rectify the said breach. In the event of a breach of the applicable anti-money laundering legislation,

the MFSA Securities and Markets Supervision Unit sends a letter to the FIAU explaining the nature of the breach identified during the Visit.

On-site compliance visits are normally held in accordance with a pre-defined schedule. The first visit is usually carried out six months after start of operations. The period which lapses between one visit and the next depends on the evaluation of the authorised person in terms of the **risk assessment model**. This model takes into consideration the following key risk areas namely: **[i]** the failure to protect clients assets; **[ii]** the case where undue profits are made at the expense of investors; **[iii]** the incompetence or negligence of management; **[iv]** the adequacy of internal controls; and **[v]** the insolvency of the authorised person.

4.2.2. Monitoring of the market and the investigation of suspicious transactions

Financial markets must function efficiently to transmit confidence, integrity and efficiency to interested parties and to society in general. A situation of market abuse undermines the trust which investors have in the financial services industry and results in a lack of willingness to participate therein. Through the monitoring of market activity, the investigation of suspicious transactions and where necessary the imposition of administrative penalties, the MFSA Securities and Markets Supervision Unit seeks to discourage market abuse. In this regard, on a daily basis, the MFSA Securities and Markets Supervision Unit monitors on and off-exchange trading in financial instruments admitted to trading on the Malta Stock Exchange with the aim of identifying suspicious trading. In addition to the latter, the market is also subject to other scrutiny through the compliance team of the Malta Stock Exchange [who monitors market activity on a real time basis] and persons authorised to arrange transactions in financial instruments, which are required to submit a report to the Authority whenever a suspicious transaction comes to their attention.

Any suspicious transactions identified are reviewed and on the basis of the conclusions therein, the MFSA Securities and Markets Supervision Unit decides whether the said suspicion should be investigated further. Where a preliminary investigation is carried out, a report is drawn up outlining the findings of the investigation. On the basis of the evidence gathered during the preliminary investigation, a conclusion is made as to whether the deemed suspicious transaction/s

could, in the opinion of the MFSA Securities Unit, tantamount to market abuse. In addition, a recommended way forward is suggested. A typical proposed way forward would normally indicate, amongst others, whether: **[a]** due to insufficient evidence the matter should be closed; or **[b]** a more thorough investigation should be conducted [either by the Authority or by the police]; or **[c]** enforcement action should be taken given sufficient evidence that the person/s investigated have committed market abuse. This report is then sent to the Authority's decision making body which deals with regulatory matters, the Supervisory Council, which, in turn, decides on the appropriate way forward.

5. CO-OPERATION AND SHARING OF INFORMATION

The Malta Financial Services Authority Act allows MFSA to disclose information to foreign regulatory authorities which require its assistance in matters relating to the regulation and supervision of financial services as well to any other body or authority formed or established under Maltese law on matters in relation to which such entity may have a regulatory, supervisory, judicial or licensing function in terms of law.

Moreover, under the ISA, FMA and the PFMAA the MFSA may request the cooperation of a European regulatory authority in supervisory functions or for on-site verifications and investigations, and a European regulatory authority may likewise request the cooperation of the MFSA.

Furthermore, the MFSA has, signed a number of bilateral Memorandum of Understandings with foreign regulatory authorities. These MOUs provide an effective framework for regulatory collaboration, investigative assistance and co-operation.

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