MFSA

MALTA FINANCIAL SERVICES AUTHORITY

MIFID II – Frequently Asked Questions ('FAQs')

Background

The Conduct of Business Rulebook sets out the conduct of business regulatory requirements for investment firms, tied agents, insurance undertakings and insurance intermediaries. These Frequently Asked Questions apply only to provisions applicable to Investment Firms.

The drafting of this Rulebook also involved the transposition of the MIFID II conduct of business requirements for Investment Firms. During this process, the MFSA has received a number of queries relating to the practical application of these requirements. In this regard, the Authority is publishing its position with respect to these queries in order to foster a more harmonised application of the MIFID II requirements in Malta.

In referring to this document the following points should be kept in mind:

- ***This document is intended to be a live document and therefore the contents thereof may be updated from time to time as deemed appropriate by the Authority***

- ***These FAQs should be read in conjunction with the "Questions and Answers on MiFID II and MiFIR Investor Protection and Intermediaries Topics" published by ESMA***

- ***The purpose of the replies provided in this document is to provide guidance to Regulated Persons with respect to the applicability of the Conduct of Business Rules. Therefore, the replies are not intended to replace or substitute legal or professional advice.***

Interested persons are welcome to submit to the Conduct Supervisory Unit, any question relating to the application of the Conduct of Business Rulebook on the following address: finpro@mfsa.com.mt.

Types of Services under MIFID II

Q.1 ***On what basis may Investment Services be offered in terms of MIFID II?***

In terms of MIFID II, Investment Services may be offered in one of the following three manners:

a. On an Advisory Basis
b. On a Non-Advisory Basis or
c. On an Execution Only Basis

Services provided on an Advisory basis imply the provision of a personal recommendation by the Investment Firm to the client as to the suitability of investment in a particular a financial instrument in the context of that particular client's investment objective, financial situation and knowledge and experience of that particular instrument ("the suitability test").

Services provided on a non-Advisory basis imply the assessment by the Investment Firm of the client's knowledge and experience vis-à-vis the instrument under consideration ("the appropriateness test"). No personal recommendation is provided by the Investment Firm to the client and therefore no assessment is carried out by the Investment Firm of the client's investment objectives and financial situation.

Services on an Execution only basis – i.e. without the carrying out of either the suitability test or the appropriateness test may only be provided on condition that **all** the following conditions are met:

a. The financial instrument under consideration is not a complex instrument;
b. The transaction is carried out at the initiative of the client
c. the client has been clearly informed that in the provision of that service, the Investment Firm is not required to assess the appropriateness of the financial instrument or service provided or offered and that therefore s/he does not benefit from the corresponding protection of the relevant conduct of business rules. Such a warning may be provided in a standardised format; and
d. the Investment Firm complies with its obligations concerning conflicts of interest.

Should one or more of the above conditions not be satisfied, the Investment Firm would not be able to provide services on an execution only basis and would therefore be required to carry out at least an appropriateness test before proceeding to provide an investment service to a client.

Research Material

Q2. What constitutes investment research?

Investment Research may be provided by an Investment Firm to its clients or it may receive such research from third parties in the course of providing Investment Services (such as portfolio management services) to their clients.

Investment Research which is provided by the Investment Firm to its client is defined as research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several financial instruments or the issuers of financial instruments, including any opinion as to the present or future value or price of such instruments, intended for distribution channels or for the public, and in relation to which the following conditions are met:

(a) it is labelled or described as investment research or in similar terms, or is otherwise presented as an objective or independent explanation of the matters contained in the recommendation; and

(b) if the recommendation in question were made by an investment firm to a client, it would not constitute the provision of "investment advice" under MiFID. This means that the recommendation in question should not be a personal recommendation.

Any investment recommendation within the meaning of Article 3(1)(35) of the Market Abuse Regulation which does not satisfy the abovementioned two criteria, shall be treated as a marketing communication and any investment firms that produce or disseminate such recommendations shall ensure that they are clearly identifiable as such.

Q3. What are the implications of providing or receiving investment research under MIFID II?

Where the Licence Holder is providing Investment Research to its clients, as defined in Q2 above, it would be required to implement certain organisational requirements. Examples of these requirements are:

-the physical segregation or (where this is not practical due to the nature, scale and complexity of the investment firm) the establishment of appropriate information barriers between financial analysts involved in the production of investment research and other relevant persons whose responsibilities or interests of the persons to whom the investment research is disseminated.

-Not promising issuers favourable research cover;

- Not accepting inducements from those with a material interest in the subject matter of the investment research (e.g. issuers)

- Prohibition of persons other than relevant persons or financial analysts producing the research, from reviewing a draft of the research for any purpose, except for the verification of compliance with the firm's legal obligations, where the draft includes a recommendation or a market price.

Where the Licence Holder receives investment research from a third party in the context of portfolio management services or other investment ancillary activities to clients, it must ensure that it either :

(a) pays for such research from its own resources; or
(b) pays for such research from a separate research account controlled by the investment firm itself funded by a specific research charge to the client and operated according to certain criteria

in order for such research not to qualify as an inducement and hence be prohibited if the investment firm in question wants to hold itself out as providing independent advice.

Q4.	***Does research material necessitate a separate fee in terms of the Conduct of Business Rulebook?***

In order for the provision of research by third parties to an Investment Firm providing portfolio management services, not be regarded as an inducement, the Investment Firm must either:

(i) pay directly out of its own resources; or
(ii) pay for research from a separate research payment account controlled by the Regulated Person.

It is important that any payments made by the client towards research through contribution in the research payment account should be disclosed separately from the fees due to the Regulated Person for any investment services provided.

Furthermore, where the Regulated Person uses the research payment account, it is to provide the following information to clients:

(i) information about the budgeted amount for research and the amount of the estimated research charge;
(ii) annual information on the total costs that each of them has incurred for third party research.

If the research received by the Investment Firm from third parties in the context of the provision of portfolio management services may be classified as a minor non-monetary benefit in terms of R.3.32 of the Conduct of Business Rulebook (Transposing Article 12 of the MIFID Implementing Directive , then it is possible to accept that research without compromising the "independent" status of the investment firm.

In particular, written material from a third party that is commissioned and paid for by a corporate issuer or potential issuer to promote a new issuance by that company, or where the third party is contractually engaged and paid by the issuer to produce such material on an ongoing basis, should be deemed acceptable as a minor non-monetary benefit subject to disclosure and the open availability of that material. In addition, non-substantive material or services consisting of short term market commentary on the latest economic statistics or company results for example or information on upcoming releases or events, which is provided by a third party and contains only a brief summary of its own opinion on such information that is not substantiated nor includes any substantive analysis such as where they simply reiterate a view based on an existing recommendation or substantive research material or services, can be deemed to be information relating to a financial instrument or investment service of a scale and nature such so that it constitutes an acceptable minor non-monetary benefit.

Q5. ***If an Investment Firm provides general investment research reports to clients would that constitute investment advice?***

General investment research reports which do not contain a personal recommendation would not constitute investment advice. In this context, it is advisable that a research report should:

- be clearly marked as 'investment research report'.
- avoid the use of the word 'recommendation' anywhere in the document especially in the context of a buy/sell/hold grading, should it contain such a grading.
- explicitly specify that the report is not personal advice to the recipient of the report;
- avoid reference to words like 'shareholders', 'investors seeking capital gains', etc which could make the opinion appear to be more personalised to a particular class of readers than it actually is.

Q6. ***Would the provision of investment research, funded by the Investment Firm itself and provided to its clients free of charge be deemed to be a bundled service in terms of Article 24(11) of MIFID II? Would such investment research be considered to trigger any form of conflict of interest?***

Article 24 (11) of MiFID II clarifies the requirements that have to be observed by an Investment Firm when bundling services. In terms of this Article, the bundling of services takes place when an investment service is offered "together with another service or product as part of a package or as a condition for the same agreement or package". Accordingly, if the investment research is not offered as an integral part of

an investment service offered by the Investment Firm or as a pre-condition for the provision such investment service, then it would not be considered as bundling services in terms of MIFID II.

Q7. ***What are the research budget requirements?***

Regulated Persons must agree the amount and frequency of the research charge to fund the research payment account with their clients. Research budgets may only be increased with a client's written agreement and must be managed solely by the Regulated Person.

Regulated Persons need to regularly assess the quality of the research, including its ability to contribute to better investment decisions and the extent it benefits clients' portfolios.

Suitability Assessment

Q8. ***Which document needs to be signed evidencing the Regulated Person has carried out its obligations when carrying out suitability assessment of its clients?***

Rule 4.4.54 of the Conduct of Business Rulebook requires a Regulated Person assessing the client's knowledge and experience with respect to a product to ensure that the document used for the testing of knowledge and experience to be signed by both the client and licence holder. In this context, both the Regulated Person and the client are expected to sign the document declaring what service is being provided to the client (i.e. whether it is providing investment advice or other non-advisory services).

Moreover, the document referred to above is the one recording the knowledge and experience testing of the client. It is therefore this document which needs to clearly indicate whether this test is being carried out as part of a suitability test and therefore the Regulated Person will be providing the client with investment advice further to this test, or whether this test is being effected further to the requirement to carry out an appropriateness test (in the context of non-advisory services). Accordingly, this document would need to be endorsed by both parties (irrespective of whether it is part of the suitability test or whether it constitutes the appropriateness test).

In practice, this would mean that this document would need to include a statement clarifying the purpose for which the client's knowledge and experience is being tested i.e. whether it is for the purpose of a suitability test, in the context of the provision of investment advice or for the purpose of an appropriateness test, in the context of non-advisory services.

An e-mail or other electronic means evidencing consent of the relevant parties to the abovementioned document would suffice.

Q9.	*Is a Suitability Statement required to be provided also in the context of portfolio management services?*

No. The requirements relating to the provision of Suitability Statements by Investment Firms to clients apply only in the context of the provision of Investment Advice.

Membership of Compensation Scheme

Q10.	*In the case of Regulated Persons issuing Structured Deposits would such deposits be considered 'term deposits' and would therefore be subject to the Depositor Compensation Scheme Regulations or an investment instrument which would fall under the Investor Compensation Scheme Regulations?*

A Structured Deposit is a banking product in respect of which certain MIFID II requirements apply. Structured deposits will continue to be covered by the Depositor Compensation Scheme and in terms of Article 14 MIFID II, where the structured deposit is issued by a credit institution which is a member of a Deposit Guarantee Scheme recognised under Directive 2014/49/EU, it will not be required to also contribute to an Investor Compensation Scheme.

Advertisements

Q11.	*Do the Conduct of Business Rules on advertisements marketed on social media apply to (i) self-managed UCITS Schemes; (ii) alternative investment funds and fund managers and (iii) fund administrators?*

In terms of Article 11(1)(b) of the Investment Services Act, all investment advertisements require approval by an investment services licence holder prior to their issue. These would include advertisements issued by self-managed schemes, alternative investment funds and alternative investment fund managers. Accordingly, in approving such advertisements, the Investments Services Licence Holder would need to ensure that the adverts in question comply with the relative requirements contained in the Conduct of Business Rulebook.

Therefore, the relevant Conduct of Business Rules would also apply indirectly to the above-mentioned entities if these consider issuing any investment advertisements, irrespective of the medium through which the investment advertisements are being issued.

Q12.	***Is the Regulated Person required to include a regulatory disclosure statement in all the advertisements it issues?***

A Regulated Person is required to include a regulatory disclosure statement, that is the fact that it is licensed by the MFSA, in all the advertisements it issues except in the case of those advertisements which consists only of one or more of the following:

(a) the name of the Regulated Person;
(b) a logo or other image associated with the Regulated Person;
(c) a contact point;
(d) a reference to the Services provided bt the Regulated Person;
(e) a reference to the fees or commissions charged by the Regulated Person.

Best execution

Q13.	***Are Regulated Persons, who do not execute or place client orders but place orders with brokers under discretionary mandate, bound to report on an annual basis the top five execution venues as required by the of the Conduct of Business Rulebook? Is this requirement applicable to UCITS management companies which receive and transimit orders for execution on behalf of clients?***

Rule 1.3.14 of the Conduct of Business Rulebook applies to those Investment Firms who execute client orders and requires them to make public on an annual basis, for each class of financial instruments, the top five execution venues in terms of trading volumes where such Investment Firms has executed client orders in the preceding year and information on the quality of the execution obtained. ESMA considers that where firms provide the service of reception and transmission of orders, such service will need to be reported separately to indicate the top five entities (brokers) to which client orders were routed during the relevant period. For further detail, reference should be made to ESMA's Q&A *on MiFID II and MIFIR investor protection and intermediaries.*

These requirements would not be applicable to UCITS management companies since, in terms of Article 2(1)(e) of MIFID II, this Directive does not apply to collective investment undertakings and pension funds whether co-ordinated at Union level or not and the depositaries and managers of such undertakings.

Q14.	***Commission Delegated Regulation (EU) 2017/576 (Regulatory Technical Standard 28) requires investment firms to report the company's top five execution venues. For which period is the Investment Firm required to report given that MIFID II entered into force on 3 January 2018?***

Investment Firms are required to publish their first report by 30th April 2018. This report should cover the activities for the year of 2017 (i.e. the preceding year). For more information, Regulated Persons should refer to the section entitled 'Best Exection' within ESMA Questions and Answers on MiFID II and MIFIR Investor Protection and Intermediaries .

Q15.	***Is there a specific format as to how Investment Firmshould report the data?***

Investment Firms are required to publish information required in accordance with Article 3(1) and 3(2) on their websites, by filling in the templates set out in Annex II of the Commission Delegated Regulation (EU) 2017/576. Investment Firms are required to make these reports available without any charges and in a machine-readable electronic format. It is also important that these reports are published on the Investment Firms' websites in an easily identifiable location on a page without any access limitations.

Disclosure

Q16.	***Is the Investment Firm required to disclose to clients the receipt (if applicable) of any discount, commissions or fees which may be received by the Regulated Person concerned from the Issuer of the financial instrument?***

Article 24(4)(c) MiFID II requires Investment Firms to disclose information on all costs and associated charges and to include therein, information relating to the service provided to the client. The Investment Firm would need to disclose to clients the receipt (if any) of any discount, commissions or fees which are received by the Regulated Person from the Issuer.