

Circular on the Regulatory Framework for ‘CRR Local Firms’ within the Maltese MiFID Investment Firms’ Framework

1. Scope and Background

Following feedback received from the industry the MFS A has considered and will be introducing the concept of ‘Local Firms’ as defined in Article 4(1)(4) of Regulation (EU) No 575/2013 (“the CRR”) and the applicability of Directive 2013/36/EU (“the CRD”) to such firms.

The purpose of this circular is to inform the industry and interested parties on the inclusion of Local Firms and the applicable supervisory regime within the Maltese MiFID Investment Firms’ Framework.

2. CRR Local Firms

The CRR excludes Local Firms from the definition of an ‘investment firm’ – Article 4(1)(2)(b). Specifically, Article 4(1)(4) of the CRR defines a Local Firm as:

“a firm dealing for its own account on markets in financial futures or options or other derivatives and on cash markets for the sole purpose of hedging positions on derivatives markets, or dealing for the accounts of other members of those markets and being guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by clearing members of the same markets.”

Therefore, in order to meet the definition of a Local Firm, an applicant has to prove that it meets the following conditions:

- (a) It is exclusively dealing for its own account or for the account of other members of the same derivatives or cash markets;

- (b) It is active on markets in financial futures or options or other derivatives;

- (c) It is active on cash markets (or spot markets) for the sole purpose of hedging positions on derivatives markets; and
- (d) The trading positions are guaranteed by clearing members of the same markets, where responsibility for ensuring the performance of contracts entered into by such a firm is assumed by those clearing members.

With respect to point (c), it is important to note that a Local Firm can be active on both derivatives markets and on cash markets, only if the investment activity on the cash markets is limited to transactions performed for the sole purpose of hedging preceding and directly related positions on the derivatives markets. Consequentially, an investment firm that performs transactions on the cash markets that are not performed for the sole purpose of hedging preceding and directly related positions on the derivatives markets, falls outside the scope of the CRR Local Firm definition.

3. Regulatory Framework

Since Local Firms qualify as MiFID Investment Firms they require authorisation. In this regard, any applicant intending to carry on the regulated activity of dealing on own account, shall be subject to the authorisation process.

Notwithstanding, Article 30 of the CRD, requires Local Firms to have an initial capital of EUR 50,000 if they use any passporting rights in terms of MiFID (either on a cross-border basis or through the establishment of a branch).

Should Local Firms envisage that they will no longer be in a position to meet the definition outlined in Article 4(1)(4) of the CRR (including through the servicing of external clients), the entity concerned shall immediately notify the Authority and apply for authorisation (as applicable) in advance of the change and in good time.

3.1 Licensing

The Maltese investment services' framework requires an applicant who intends to undertake the investment services activity of 'Dealing on own account', to apply for a Category 3 investment services licence. Through a Category 3 Investment Services Licence, a Licence Holder may be authorised "*to provide any Investment Service and to hold and control Clients' Money or Customers' Assets*¹". In view of this, for the purpose of the licencing of Local Firms, the licence of such entities will limitedly authorise them to 'Dealing on own account' within the

¹ Investment Services Rules For Investment Services Providers, Part A: The Application Process (Last updated: 16 February 2018)

limits of the activities stipulated in Article 4(1)(4) of the CRR, and will specifically prohibit such licence holders from holding and/or controlling clients' monies.

Over and above the documents required in support of an application for a licence, the following additional documents are to be provided to the Authority at application stage:

- i. A certified statement signed by the applicant's management board, compliance officer, and, if applicable, the management board of its parent company confirming that the proprietary trader will comply with and is able to continue complying with the definition of 'Local Firm' in terms of Article 4(1)(4) of the CRR on an ongoing basis. In this statement, the management board shall also declare that they will immediately inform the Authority should the entity would not be able to continue doing so and/or intend to change its operations;
- ii. A certified legal opinion endorsed by the applicant's management board and, if applicable, the management board of its parent company issued by an independent, external third party or an internal legal department confirming that the proprietary trader will comply with and is able to continue complying with the definition of Local Firm in Article 4(1)(4) of the CRR on an ongoing basis; and
- iii. Sufficient written evidence showing how the proprietary trader complies with the definition of a 'Local Firm' in its internal operating manuals (e.g. the trading strategy, hedging and off-setting strategies, and the investment policy) (applicable only to existing entities).

3.2 Ongoing Regulatory Requirements

The applicable regulatory framework reflects the current EU legislation framework based on the CRD. In this regard, Local Firms shall be required to have their Financial Resources Requirement at least equal to an initial capital of EUR 50,000.

In addition, on the basis that Local Firms do not service any external clients, any rules or rulebooks in relation to clients (including the conduct of business obligations), and/or client monies and/or assets under MiFID II would not be applicable.

Nonetheless, other MiFID prudential rules remain applicable and such firms will still be subject to the Authority's on-going monitoring and supervision. The changes to the rulebook/s reflecting the provisions of this circular will be undertaken in due course.

4. Contact

Any queries regarding this Circular shall be sent to the Securities and Market Supervision, MFSA at: investmentfirms@mfsa.com.mt.

Applications for authorisation of Local Firms shall be submitted to the Authorisation Unit at: ausecurities@mfsa.com.mt.



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