MFSA

MALTA FINANCIAL SERVICES AUTHORITY

CONSULTATION DOCUMENT

CONDUCT OF BUSINESS RULEBOOK
PHASE 2

[MFSA REF: 04/2016]

11 April 2016

Closing Date: 31 May 2016

Note: The documents circulated by the MFSA for the purpose of consultation are in draft form and consist of proposals. Accordingly, these proposals are not binding and are subject to changes and revisions following representations received from Licence Holders and other involved parties. It is important that persons involved in the consultation bear these considerations in mind.

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CONSULTATION

CONDUCT OF BUSINESS RULEBOOK

PHASE 2

Introduction

On 6 May 2015 the Malta Financial Services Authority ("MFSA") entered into the first phase of a consultation procedure through the issuance of the "*Consultation document relating to* the *creation of a proposed Conduct of Business Rulebook*" (**Ref.04/2015**). This consultation procedure follows the previous consultation undertaken by the MFSA regarding the "*Proposed Conduct of Business Rules for the Enhanced Protection of Customers in Investment Services*" (**Ref.03/2014**) which was issued by the MFSA for consultation on 27 January 2014.

As indicated in the above consultation, the Rulebook is addressed to persons licensed under the Investment Services Act (excluding custodians) and to persons carrying on insurance activities in terms of the Insurance Business Act or the Insurance Intermediaries Act (insurance undertakings and insurance intermediaries), and individuals who work with or advise such entities, as well as persons licensed as credit institutions under the Banking which sell or advise clients in relation to structured deposits, where applicable. The Rulebook is aimed at setting out the regulatory requirements of regulated persons, insofar as their conduct vis-à-vis their clients, is concerned. The first phase of this consultation procedure tackled the topics of: (1) Client Disclosures and Reporting; (2) Product Governance; and (3) Conflicts of Interest.

What does Phase 2 deal with?

The purpose of this second phase of consultation is to obtain the industry's views on the following chapters in the proposed Conduct of Business Rulebook:

1. Selling Process and Practices (including Contractual Agreement with Clients)
2. Execution of Clients' Orders

As was the case with the Chapters already issued for consultation under Phase 1,, each of the Chapters will comprise a General Part which will apply across the board to all the types of Regulated persons as defined in the Glossary to the Rules. The Chapters shall consist of other Parts containing Rules which are particular to a specific type of Regulated person and which would therefore apply only to the types of Regulated person indicated in the applicability clause contained in the relevant Part.

Context and Sources of Proposals

These draft rules are mainly a transposition of the relevant requirements set out in the relevant EU directives applicable to Regulated Persons as defined in the Glossary to the Rulebook, as well as any relevant Level 2 measures. Furthermore, the draft rules also reflect Technical Advice issued by ESMA and which was presented to the Commission for the latter to issue Level 2 Measures under MiFID II. To date,EIOPA has not issued Technical Advice for Level 2 Measures under IDD.
It is to be noted that MiFID II shall be transposed into national legislation by not later than the 3 July 2016. It would however appear that the European Commission plans to postpone the implementation date of MiFID II by one year to January 2018. In the meantime, the IDD has entered into force with effect from the 23 February 2016 and shall be implemented by latest 23 February 2018. The MFSA is also closely following developments relating to Technical Standards being proposed by EIOPA and ESMA which could result in changes to the Conduct of Business Rulebook. In the interim, during this transitional period, the MFSA would encourage effective preparation by the industry to ensure compliance with MifID II and IDD, once applicable.

In drafting the Chapters which are the subject of this consultation document, the MFSA has retained the approach adopted in the first phase of consultation, whereby certain provisions which are found in the draft IDD and certain other opinions and guidelines issued by EIOPA which the MFSA believes can be applied to persons licensed under the Investment Services Act, have been extended to apply to such persons, in areas which are not covered by MiFID II. This approach mirrors the one adopted at EU level, whereby cross-sectoral legislation is being promoted (in particular in the area of conduct of business) to ensure consistency in the financial markets. Conversely, certain provisions which are found in MiFID II as well as opinions and Guidance issued by ESMA and which in the opinion of the MFSA could apply to persons regulated under the Insurance Business Act or the Insurance Intermediaries Act are also so applied to latter category of Regulated Persons in the Rule Book. Nevertheless, this exercise was not carried out indiscriminately and therefore one should pay close attention to the applicability provisions in each section of each chapter of the Rulebook.

What are you required to do next?

The MFSA is seeking feedback on the proposals set out in this second phase of the Consultation Procedure relating to the Proposed Conduct of Business Rulebook. Responses should reach the MFSA by **31 May 2016**.

Please send your responses by email to **csu@mfsa.com.mt** or alternatively by conventional post and addressed to: **The Director – Conduct Supervisory Unit, Malta Financial Services Authority, Notabile Road, Attard**.

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The next step

The first phase of this consultation procedure was concluded on 10 July 2015. The MFSA is currently in the process of reviewing the feedback received from the industry in relation to this consultation document and finalising the first three chapters of the Rulebook. Following the feedback received, the MFSA is minded to propose changes in the approach indicated in the first phase of the consultation procedure, such as a change in the approach for the sale of complex instruments and a revision to the List of Documents required to be provided to Clients in both Maltese and English. The aforementioned proposed approaches are explained in more detail in this Consultation Document.

A feedback statement will be issued by the MFSA on all the chapters of the proposed Rulebook, on conclusion of the entire consultation procedure when the finalRulebook will be published upon conclusion of the entire consultation procedure. Regulated Persons will be granted a transitional period to comply with requirements emanating from this new Rulebook. Further details will be announced by the MFSA at a later date.

MFSA Consultation Procedure – 27th January 2014 – MFSA's Feedback

The MFSA refers to the Consultation document issued on the 27th January, 2014 (**Ref.03/2014**) regarding the "*Proposed Conduct of Business Rules for the Enhanced Protection of Customers in Investment Services*".

Following the assessment of the feedback received by the MFSA from various interested parties, the MFSA has decided to take up the following recommendations with respect to the issues relating to the scope of the current Consultation Document, namely: Selling Process and Practices (including Contractual Agreement with Clients) and Execution of Clients' orders:

Recommendation (numbered as in the 27th January 2014 Consultation Document)	Industry Feedback	MFSA Position:
Recommendation 1: An Investment Services Licence Holder ("ISLH") which holds itself to a client/potential client to be acting 'independently' should satisfy the fair analysis test of providing investment advice based on a fair and comprehensive analysis of investment products available on the market which are suitable based on the client's objectives and needs. In the interest of reinforcing trust and confidence in ISLHs, all types of investors (whether retail or professional) should be directly informed by the Investment Services Licence Holder whether the investment advice given is 'independent' or 'restricted' advice regardless also of the type of investment product being offered. Moreover a firm that does not	One respondent expressed its general agreement with the recommendation although it did not agree that if a firm excludes itself from providing advice on specific products, then this would mean that it is giving restricted advice. Another respondent stated that it disagreed that "Independent investors should satisfy the fair analysis test, as offering access to all products on the market, which may be suitable for a customer", and questioned whether the word "all" should be taken in the literal	**The MFSA has implemented this recommendation relating to the fair analysis test in the chapter relating to the Selling Process and Practices and has clarified the criteria which would distinguish between "independent" and "non-independent" advice. The proposed rules set out further details on what would constitute a "fair and comprehensive analysis" of the products available on the market.** **The rule relating to the requirement to inform clients whether the Regulated person is providing independent or non-independent advice has been implemented in the Chapter on Disclosures which formed part of Phase 1 of this Consultation Procedure, by means of a transposition of the relevant requirements set out in the relevant EU directives applicable to Regulated Persons as defined in the Glossary to the Rulebook, as well as any relevant Level 2 measures.**

advise on the full range of products is providing advice that has been restricted and this advice should be labelled as such. In such case, the firm should clearly disclose to the customer the names of those companies whose products or services it distributes.	sense, as in, every single fund, bond, share suitable for the client must be offered to him. The respondent stated that this would constitute too wide an exercise to carry out. Another respondent stated that it is not clear what the criteria are for the classification of “independent” and “restricted” advice due to the practical impossibility of offering “access to all products on the market” The respondent stated that the real issue should relate to the disclosure of conflicts of interest and inducements in particular.	
Recommendation 2 Employees of Investment Services Licence Holders who are authorised to provide investment advice should be designated as investment advisors. Those employees who are not authorised to provide investment advice should be designated as Investment Non-Advisors.	Most respondents agreed with this recommendation although they expressed their disagreement with the suggestion to designate those employees who are not authorised to provide investment advices as Investment	**The MFSA took on board the suggestion not to include the requirement relating to the “Investment Non-Advisor” designation. The MFSA instead introduced a requirement in the Chapter on Disclosures for a Regulated Person to ensure that any designation given to its employees reflects the Service being provided by such employee, and also requires that the employee shall clearly disclose whether he is authorised to give advice and whether the Service being**

	Non-Advisors. One respondent stated that a firm or person providing Restricted Advice or that is an agent or distributor of products of a particular issuer ought to be impeded from describing itself as an Independent Financial Advisor, and likewise its sales staff ought to be impeded from describing themselves on business cards etc as "Financial Planning Advisors". Furthermore, there should be a prohibition for a person to describe himself as "advisor" if the firm he represents also provide Execution-Only services. Only one respondent expressed complete disagreement with this recommendation and proposed that before a meeting with the client or potential client takes place, the advisor should introduce himself to the client and present a brief or an address to the MFSA website were the client can check the profile of the advisor. The respondent also	**provided is of an advisory nature or otherwise.**

	opined that the designation should be left intact but a clearly visible line is introduced in business cards to show whether the advisor is licensed or not.	
Recommendation 3: In the interest of transparency and consumer protection, it is recommended that the same approach as adopted under the Insurance Intermediaries Legislation is also applied to Investment Services Licence Holder. Therefore, it is recommended that the Authority should keep a register to which the public has access (to be published on the MFSA website) containing a list of all individuals within an ISLH who are issued with MFSA's authorisation to provide investment advice and portfolio management.	 Only one respondent provided feedback to this recommendation, which respondent was in agreement with this proposal.	 **This Recommendation will be implemented through a proposed amendment to the Investment Services Act, and the "Investment Advisors" List has also been referred to in the definition of Register provided in the draft Glossary to the Rulebook.**
Recommendation 4: It is recommended that the promote and sell regime be removed from the local regulatory framework whilst retaining the practice arising from its definition, that is, giving objective information without making any comment or value judgement on its relevance to decisions which an investor may make.	 Most respondents agreed with this recommendation to ban the Promote and sell regime, one of whom also stated that one should be careful not to merely abolish the title "Promotion and Selling" without banning the service itself as this would	 **This Recommendation has been implemented by the MFSA, as any reference to the "Promotion and Selling" regime was deleted from the draft Chapter on Selling Process and Practices.**

	only lead to a situation of further confusion. Another respondent stated that, while it is true that for some retail clients, it may not be appropriate to offer complex products only on a "promote and sell basis", this is an assessment to be made on a case by case basis in accordance with the relevant rules on client profiling. This respondent also expressed the view that if the proposal is to abolish so-called promotion and selling and to restrict execution-only services to professional clients and to practically oblige licence holders to provide investment advice in relation to any "complex product", such measure would be disproportionate. The effectiveness of an assessment of the client's financial situation and investment objectives, in addition assessing the client's knowledge and experience with certain products and services, was also	

	questioned. The respondent also stated that the scope for execution-only services appears to be very limited already (especially in view of ESMA's opinion on the matter), as well as under MiFID II.	
Recommendation 5: The Authority reformulates its local legislative framework so that the latter is solely and clearly based on two pillars: - Advisory investment services; - Non-Advisory investment services. The presumption should be in favour of an advised transaction. There should be clear disclosures of the firm's level of care for the different categories of advisory services.	One respondent expressed its agreement with the proposal that services should only be categorised under these two broad categories, as well as with the proposal that the presumption should be in favour of an advised transaction. However such respondent disagreed that "there should be clear disclosures of the firm's level of care for the different categories of advisory service"; as they stated that there is only one category of advisory service. Another respondent stated that the concept "standard of care" and client profiling should not be treated as one and the same: in all cases, the	**This Recommendation was implemented in the Chapter relating to Selling Process and Practices.**

	firm is required to abide by the general rule that it must act "honestly, fairly and professionally in accordance with the best interests of its clients" and other relevant conduct of business and disclosure rules derived from MiFID – thus stating that there is "no care at all" can be misleading). As far as client profiling is concerned, both the appropriateness and suitability test require that an assessment is made of the client's knowledge and experience in the investment field relevant to the specific type of product or service to assess whether the investment service or product envisaged is appropriate for the client. Since reference is made not only to the product, but also the service, it could be argued that licence holders need to assess whether or not it is appropriate for the client to receive a service involving only receipt and transmission or execution of orders in	

	respect of the product(s) concerned, or whether it would be better for the client to receive investment advice. If services other than investment advice or portfolio management are offered, the licence holder is required to warn the client if it considers the service or product not to be appropriate.	
Recommendation 6: In the context of the previous recommendation, an additional recommendation is for the MFSA to issue guidance to the market on what is deemed by the Regulator to constitute an advised sale and a non-advised sale. This could be achieved by introducing a section in the Guidance Notes which is modelled on the guidance published by CESR in 2010.	Respondents agreed with this recommendation although one respondent requested further clarification with respect to the term "Non-Advisory Services", and this in view of the perceived ambiguity in the Consultation Document as to whether the provision of the "Promotion and Selling Service" shall continue to exist or otherwise.	**Such guidance has been included in the Chapter relating to Selling Process and Practices.**
Recommendation 7 In respect of each individual transaction completed on an execution only basis, the ISLH be required to: (a) justify and	With respect to Recommendation 7(a), whilst some respondents agreed with the introduction	**The MFSA has included a number of proposed rules and guidelines relating to record-keeping in the draft Chapter on Execution of Clients' Orders, also reflecting ESMA's draft implementing**

demonstrate, through documentary evidence, the manner in which the firm has satisfied itself that the service is being provided at the initiative of the client and to keep a record thereof; (b) ask the client to specify the manner, medium or means through which he/she became aware of the specific investment product which is being purchased from the ISLH concerned. It is important here to establish whether the ISLH has made prior contact, whichever the form such contact may take, with theclient/potential client in relation to the investment product in question. The answer to such question, together with any supporting documents, should form part of the documentary evidence to be held in terms of paragraph (a) above. (c) Execution only transactions should not be a default option – possibly allowing such a transaction only in respect of professional clients.	of additional record-keeping requirements, other respondents stated that existing record-keeping requirements under MiFID are sufficiently comprehensive. One respondent also explained that most local firms are or were using the template Client Fact Find forms found in the Investment Services Rules for Investment Services Providers, as a basis, which forms already include a section for client's signature, containing certain risk warnings. Most of the respondents to this Recommendation opined that the proposal that execution only transactions can only be executed for professional clients (Recommendation 7(c)), would be going overboard and outside the spirit of MiFID. One respondent proposed that what could be considered is that Execution Only transactions in complex products would only be undertaken for professional clients.	**measures. It should also be noted that the template Client Fact Find which so far forms part of the Investment Services Rules, will not be included in the proposed Conduct of Business Rulebook.** **In so far as Recommendation 7(c) is concerned, the MFSA has taken on board the industry's suggestion. In this regard, Recommendation 7(c) has not been implemented.**

Recommendation 8 A Statement of Compliance is applied as a mandatory requirement and is modelled on the same lines as currently applied in the UK. The Statement of Compliance should be looked at as a tool to increase awareness by the client/potential client of the type of service being provided. It should not act, as has been described by the FCA, as a “get out of jail free card”.	 Whilst some respondents to this recommendation agreed with this proposal, they stated that if applied to all products and securities, even those of a non-complex nature, this would be exaggerated in its effect. A Risk Disclosure Statement alerting customer to the risks of Execution Only Services and of the various types of security in a standardised format – such as the Investment Agreement – as is currently the practice, should suffice.	 **The MFSA has decided not to implement this requirement as a mandatory Statement of Compliance.**
Recommendation 9 Similar to what has been adopted in the UK, a more straight forward and clear definition of Execution only services is included in our subsidiary legislation which sets out the main concepts of an execution only transaction, namely that it is a transaction executed by an ISLH (a) at the client’s initiative, (b) without the provision of investment advice and (c) where the client takes full responsibility for the instructions provided.	 Respondents agreed with this recommendation.	 **This recommendation was implemented in the chapter relating to Selling Process and Practices, wherein the definition of Execution only services has been clarified.**

Recommendation 10 A suitability report is introduced as a mandatory requirement for investment firms providing advisory services to retail clients	One respondent stated that such a requirement would be unduly bureaucratic as it would involve an inordinate and unreasonable time to write reports, whilst the focus should be on the Regulated Person having to issue a declaration for each transaction that it is suitable, and that in case this assessment is challenged, such Regulated Person would have to justify its assessment. Another respondent, whilst agreeing in principle with this requirement, stated that it would not be feasible with respect to clients who approach the investment firm on a frequent basis (weekly, monthly). Another respondent stated that imposing the suitability test where no investment advice or portfolio management services are provided would be in breach of MiFID and ought to be avoided. This respondent proposed that the MFSA should issue	**The MFSA is introducing this requirement (referred to in the Rulebook as a Suitability Statement) for Regulated Persons providing advisory services and portfolio management services to clients, whether retail or otherwise, both in the Chapter on Disclosures and in the Chapter on Selling Process and Practices. The Rules cater for certain exceptions with respect to the provision of such services to Professional Clients. This is a new requirement under both MiFID II and IDD.**

	guidance in the form of best practice guidelines on how the various rules are to be applied and interpreted, but only insofar as no other guidelines are available from ESMA.	
Recommendation 11 An appropriateness report should be introduced as a mandatory requirement for investment firms providing non-advisory services to retail clients.	Respondents provided the same feedback provided in relation Recommendation 10, and requested further clarification. One respondent also added that since Recommendation 11 refers to the appropriateness report [read 'Test'] introduced as a mandatory requirement for investment firms "providing non-advisory Services to retail clients", this seems to imply that the Promotion and Selling Service does not seem to have been abolished, and therefore further clarification was requested in this regard as well.	**The MFSA has decided not to implement Recommendation 11 for the introduction of an appropriateness report.**
Recommendation 12: The Authority issues guidance	The respondents who	**This Recommendation has been**

on good and best practices concerning the application of the suitability and appropriateness tests, which guidance could include lessons learnt from recent cases of consumer detriment.	provided feedback to this recommendation were all in agreement with this proposal.	**implemented through the inclusion of various Guidance provisions relating to the suitability and appropriateness tests, in the chapter relating to Sales Process and Practices.**
Recommendation 13A: In respect of the Specimen wording of the Client Fact Find for the Suitability and Appropriateness test, the following is being recommended: a) The Guidance Notes should clarify that the templates should be used as a guide on the minimum questions which should be included in the respective tests. An emphasis should be included in the Guidance Notes that additional questions may be included by the ISLH as part of such tests, depending on the type of service, client and complexity of the product. b) The option given to the client/potential client in the Specimen wording of the Client Fact Find of not requiring a copy of the Suitability or Appropriateness test is deemed to be a practice which is not in the best interest of the investor. It is therefore recommended that such option be removed from the Specimen wording of the Suitability and Appropriateness tests appended to the Guidance Notes and consequently	Respondents to this Recommendation were mostly in agreement with the proposals set out therein.	**The MFSA has decided not to provide for Specimen wording of the Client Fact Find for the Suitability and Appropriateness in the proposed Rules. However, as indicated above, the MFSA is introducing detailed guidelines in relation to such tests.**

imposing the mandatory requirement on ISLHs to provide the client with a copy of the respective test/client fact find.		
Recommendation 13B All firms should be required to gather information from customers (Client Fact Find) for the purpose of the Suitability or Appropriateness test. The Client Fact Find would determine the reasons why a firm has deemed a particular product to be suitable or appropriate to the customer.	One respondent stated that a particular product should be deemed to be suitable to a customer who is receiving advice, to the value and extent recommended; in other words and by way of illustration, whilst a particularly high percentage in equities may not be suitable for a specific customer, a lower percentage may be altogether suitable and acceptable. It is not only the nature of the product itself that determines suitability, but the extent of diversification and value / exposure involved that are relevant in such considerations.	**Although no recommended specimen wording for a Client Fact Find is being included in the proposed Rules, the chapter on Selling Process and Practices still includes a requirement for Regulated Persons to gather such information from Clients for the purpose of the Suitability or Appropriateness test.**
Recommendation 14 It is recommended that the Specimen wording of the Suitability and Appropriateness tests be revised as follows: a) A question is introduced under the section relating to	Some respondents questioned the efficacy of certain specific questions, particularly the question relating to education and literacy	**The MFSA has decided not to include any specimen wording relating to suitability and appropriateness tests.**

education asking specifically about the literacy level of the potential client; b) In the Suitability test template, under the section headed 'Investment Objectives, Planning and Risk Profile', it is recommended that the question "What is the investor's attitude towards risk? Low? Medium? High?" should be augmented by requesting the ISLH to explain why such rating c) Under the section headed 'Assessment of Suitability' and 'Assessment of Appropriateness', the ISLH should not simply answer the question by indicating a 'Yes' or a 'No'. In each case the ISLH should substantiate the answer given to each of these questions by explaining the reason for such answer. d) In order to prompt the provision of such information, it is recommended that the format of such section for both tests be amended as follows so as to avoid that such tests be used merely as a tick-box exercise.	level as well as the proposed point (c)	
Recommendation 22 Suitability tests should be strong enough to ensure that their objective is effectively met, such that investment products sold to clients are suitable for them. Appropriate conflicts of interest management and controls by the compliance function should be in place to	No feedback to this recommendation was received from the industry.	**This Recommendation has been implemented in the Chapter relating to Selling Process and Practices.**

ensure that the investment advice provided is not biased.		
Recommendation 37 It is recommended that the MFSA should not engage in pre-approving investment products. The arguments set forth both by the FSA in the United Kingdom and by senior officials within the MFSA in this regard are that a product "approved" by the regulator might imply that it cannot fail, thus giving rise to moral hazard. Moreover, pre-approving of products would require onerous staffing requirements possessing market-oriented expertise. Lack of the foregoing would imply considerable delays in products being approved, thus stifling competition and limiting choice for consumers.	Most respondents agreed that there should not be the introduction of any regulatory approval of products. One respondent however suggested that complex products marketed in Malta should undergo a regulatory process which enables the regulator to prohibit its marketing (negative approval). Another respondent agreed with the Authority that there needs to be a level of monitoring when it comes to promotion of complex products, although they suggested that not all products categorized under complex products carry the same level of risks. This respondent also proposed that these products should be vetted on the basis of volatility of the underlying investments, historical records of the underlining instruments and the liquidity of the same underlying	**The MFSA has decided not to engage in pre-approval of investment products. Furthermore it should also be noted that the Chapter relating to Sales Process and Practices will provide that only certain types of complex products are to be sold on an advisory basis.**

	instruments. Another respondent also stated that more product regulation would not be desirable, and that complex products should only be dealt with by competent persons. However they disagreed with the requirement for licence holders to provide advisory services (and thus to carry out a suitability test) as this would be going beyond MiFID.	
Recommendation 38 It is recommended that a pictorial representation similar to the one presented by CESR for risk disclosure in the UCITS' KID is introduced in the marketing materials for highly complex structured financial instruments with a high risk of mis-selling. The onus would be on the product provider to "grade" the risk of the particular investment product. However, it would be important to ensure that consistent pictorial representation of risk was underpinned by a consistent methodology for the calculation of the risk level of different funds to ensure accurate benchmarking. Such consistent methodology might be outlined in the form of a rule published by the MFSA requiring authorised	 The one respondent to this Recommendation stated that clarification is needed as to whether this means that all products should contain a risk rating, and who is responsible to determine such ratings. Ratings should be consistent to avoid different risk ratings being adopted for the same products, as this is clearly not in customers' interest.	 **This Recommendation is not being implemented in the proposed Rulebook**

undertakings to take specified steps in connection with the setting of benchmarks.		
Recommendation 40 It is recommended that the MFSA implements a similar approach as is implemented in France – and is being proposed in the United Kingdom – for products with highly complex structured financial instruments with a high risk of mis-selling to carry a warning that the MFSA considers such products as being too complex to be marketed to retail investors. Alternatively, the MFSA could publish a list of products that are regarded as being generally unsuitable for the mainstream, retail market.	The one respondent to this Recommendation was in agreement with this proposal.	**The MFSA has decided not to adopt this Recommendation and it will not be designating any products as being 'highly complex'.**
Recommendation 42 The MFSA should consider the appropriateness of requiring that investment products that are particularly complicated, or where there is a high risk of consumer detriment, should only be sold using advised distribution channels.	One respondent expressed its agreement to this Recommendation but proposed that the text "advised distribution channels" should read "on an advisory or discretionary basis" because evidently the purpose of the Recommendation is to outlaw an abusive sale on an execution-only basis and not to impede a transaction on a discretionary basis when the ISLH is assuming its responsibility for the	**The MFSA is proposing that only certain types of complex products are sold on an advisory basis.This is reflected in the proposed Chapter on Selling Process and Practices.**

	suitability of the security transaction involved for the particular client. Another respondent stated that this recommendation may go beyond the scope of MiFID.	
Recommendation 44 The MFSA might consider banning products or banning product features to be sold to retail investors, when such products have the potential to cause significant consumer detriment but only as a measure of the last resort, since it is likely that products that are not banned will be perceived by consumers as having been approved for sale by the regulator.	 No feedback to this recommendation was received from the industry.	 **The MFSA will not be banning any particular products or product features from being sold to retail investors. However, the intention is to require certain types of complex products to be sold only on the basis of investment advice.** **Furthermore, article 42 of MiFIR, which grants powers to the MFSA in relation to product intervention. It is expected that the implementation date of this Regulation shall be postponed to January 2018.**

MFSA Consultation Procedure – 6th May 2015 – MFSA's Partial Feedback

The MFSA refers to the Consultation document issued on the 6th May 2015 (**Ref.04/2015**) regarding the "*Conduct of Business RuleBook – Phase 1" and is proposing some changes as follows:*

List of Documents which are required to be provided to Clients in both Maltese and English

In the light of feedback received by the MFSA from the industry requesting reconsideration of the list of documents which are required to be provided to Clients in both the Maltese and English language as stipulated by **R.1.1.4 of Chapter 1 (Disclosures)**, we are now proposing that the list of documents to be provided by Regulated Persons in both Maltese and English is revised as follows:

Documents relating to Services Provided by Regulated Persons falling under points (i), (ii) or (v) of the definition of Regulated Person in the Glossary to these Rules :

i. Client Agreement required in terms of Article 25(5) in MiFIDII;

ii. Client Fact Find which is used by the Regulated Person to gather the information required in order for it to assess the suitability or appropriateness of the Client with respect to the Services or Products being sold;

iii. Suitability Statement required in terms of R.1.4.17 including, the periodic assessment of suitability required in the case of portfolio management services.

Documents relating to Services Provided by Regulated Persons falling under points (iii) or (iv) of the Definition of Regulated Person in the Glossary to these Rules :

iv. Insurance Policy;

v. Proposal Form;

vi. Suitability statement required in terms of R. 1.4.17.

vii. The Statutory Notice to be provided to Clients in terms of the Insurance Business (Long Term Business Contract Statutory Notice) Regulations.

viii. The Statutory Notice Required in terms of Insurance Intermediaries Rule 4 – Code of conduct for Insurance Intermediaries (Bancassurance statutory notice).

Provided that where the subject of the contract of insurance relates to the business of reinsurance or to large risks as defined by Article 5 of the Second Council Directive 88/357/EEC of the 22nd June 1988 on the coordination of laws, regulations and administrative provisions relating to direct insurance other than the life assurance and laying down provisions to facilitate the effective exercise of freedom to provide

services and amends Directive 73/239/EEC, the information referred to in this rule shall be provided in English, or in any other language agreed to by the parties.

Question: Do you agree with the above list as to the documents which are to be provided in both Maltese and English? Please provide reasons if you disagree. Please indicate any other documents which you feel should also be included in the list.

Section 1: Selling Process and Practices (including Contractual Agreement with Clients)

Overarching obligations

Regulated Persons who sell Products and Services to Clients are required to act honestly, fairly and in accordance with the best interests of such Clients. Such Regulated Persons are also bound to conduct their activities with utmost good faith, integrity, due skill, care and diligence. To this end, all Regulated Persons are subject to a number of requirements relating to the selling process and practices applied to such products and services, to ensure that Regulated Persons take all the necessary steps to satisfy the needs and requirements of their Clients. These include specific requirements relating to the information which Regulated Persons are expected to gather in order to fulfil such overarching obligations.

Personal Visits and Contact with Clients

The proposed rules set out requirements and standards which a Regulated Person is required to adhere to when establishing contact with clients. These include rules relating to personal visits to clients, unsolicited or cold calls, telephone calls with clients, and general standards to be adopted by staff members involved in the selling of products or services. These rules also establish additional record keeping requirements relating to such meetings with clients.

Client Categorisation

Regulated Persons falling under points (i) or (ii) of the definition of Regulated Person, namely investment services licence holders and tied agents, are required to classify their clients as Eligible Counterparties, Professional Clients or Retail Clients prior to the provision of any Service as defined in the Glossary to the proposed rules. Such categorisation will determine the level of protection which should be afforded by a Regulated Person to its clients, with Eligible Counterparties requiring the least level of protection and Retail Clients requiring the highest level of protection. It is generally understood that the former are very knowledgeable about and experienced with respect to the Products and Services being offered by the Regulated Person, whilst the latter would be deemed to possess little, if any, knowledge and experience concerning the relevant Services and Products. Furthermore, the Rules also differentiate between 'Per Se Professional Clients' and 'Elective Professional Clients', and 'Per Se Eligible Counterparties' and 'Elective Eligible Counterparties'. The proposed rules also require Regulated Persons to have in place written internal policies and procedures to categorise Clients. These include record keeping requirements relating to the client categorisation process.

Vulnerable Clients

The category of "Retail Clients" covers a broad spectrum of persons who do not fall under the definition of professional clients. Not all Retail Clients are equally unable to assess whether a product is suitable or appropriate for them even after having received an explanation from a Regulated Person. Consumers in vulnerable circumstances may be significantly less able to represent their own interests and more likely to suffer harm that the average retail client.

MFSA is proposing the introduction of a new concept, namely that of "Vulnerable Clients".The MFSA is proposing to request Regulated Persons to identify whether any current or potential clients may be deemed to be "vulnerable". A Vulnerable Client is someone who, due to their personal circumstances, is especially susceptible. In determining whether a Client may be deemed to be "vulnerable" Regulated Persons should consider, *inter alia*, the following factors:

- Low literacy, numeracy and financial capability skills
- Physical disability
- Sever or long-term illness
- Mental health problems
- Low income and/or debt
- Caring responsibilities (including operating a power of attorney)
- Being "older old", for example over 80.
- Being young (associated with less experience)
- Change in circumstances (e.g. bereavement, separation or divorce)
- Lack of English language skills
- Non-standard requirements or credit history (e.g. ex-offenders, care-home leavers, recent immigrants)

The MFSA is proposing Guidelines under the Chapter on Sales Process and Selling Practices applicable if a Regulated Person is dealing with a vulnerable client.

Questions:

i. **Do you agree with the position being considered by the MFSA in this regard? Please let us have your reasons.**
ii. **Are there other factors the MFSA should take into account to determine whether a Client may be deemed to be "vulnerable"?**
iii. **Do you have any suggestions on the Guidelines being proposed?**

Advice and Non-Advice

The proposed Rules set out parameters and guidance to determine the circumstances which would amount to a Regulated Person providing advice. Furthermore, the Rules also cater for the differentiation between Independent Advice and Non-Independent Advice, laying down certain specific requirements which would apply depending on the nature of the advice being provided by the Regulated Person, as well as a number of specific rules and guidelines applicable to Regulated

Persons offering both types of advice. The Rules relating to Advice also cover issues relating Investment Research.

Assessment of Client's Suitability and Appropriateness

It should be noted that while these Rules relating to assessment of client suitability and appropriateness apply to both investment service licence holders and insurance service providers, the latter are only required to comply with such requirements in so far as they provide services in relation to insurance-based investment products. This reflects the requirements of IDD.

A Regulated Person who provides Advice or Portfolio management services to a client, is required to carry out a suitability assessment which consists in obtaining the necessary information regarding the Client's knowledge and experience in the field relating to the specific type of Product or Service being sold, the client's financial situation including his ability to bear losses, and his investment objectives including risk tolerance. The Chapter relating to the Selling Process and Practices includes rules and guidance with respect to the manner in which such a suitability assessment should be carried out. The Rules make it clear that responsibility for this suitability assessment lies with the Regulated Person, to ensure that the best interests of the client are observed. Furthermore, a Regulated person providing Advice or portfolio management Services, is required to provide the Client with a suitability statement prior to affecting the transaction. The minimum requirements of such a suitability statement are also provided within the proposed Rules.

A Regulated Person who offers a service **other than Advice or portfolio management**, is required to carry out an assessment of appropriateness. Subsequently, if on the basis of the information obtained from the Client, the Regulated Person does not consider the Product or Service to be appropriate for such Client, the Regulated Person is required to warn the Client to that effect. The Client must also be given a warning to the effect that the Regulated Person will not be in a position to determine whether the Service or Product envisaged is appropriate for him, if he fails to provide the necessary information or if the information provided is insufficient. The Rules provide that both warnings may be provided in a standardised format. With respect to Professional Clients, the Rules cater for an assumption that such clients have the necessary experience and knowledge to understand the risks involved in relation to the particular Services or Products for which such clients have been classified as Professional Clients. The Rules also cater for specific requirements applicable to the appropriateness assessment in relation to bundled Services or Products, where the Regulated Person is required to ensure that the overall bundled package of Services or Products is appropriate for the Client.

Exemptions from Appropriateness Test

The Rules provide for specific circumstances wherein Regulated Persons are not required to carry out the appropriateness assessment. Such an exemption is applicable to Regulated Persons who provide services consisting of execution or reception and transmission of client orders with or without ancillary services, excluding the granting of credits or loans that do not comprise of existing credit limits of loans, current accounts and overdraft facilities of Clients, as well as Regulated

Persons carrying out insurance distribution services, provided that certain conditions as set out in the Rules are fulfilled. It is important to note that Products which do not fall under the criteria of non-complex products as set out in the proposed Rules, will be deemed to be complex products and the Regulated Person selling such products must always carry out an appropriateness test.

One of the circumstances where the exemption from the appropriateness test shall apply relates o when the Service is provided at the initiative of the Client. In this respect, the proposed Rules also include detailed guidelines aimed at establishing when a service is deemed to be provided at the initiative of the Client. Guidelines are also provided in relation to the minimum requirements which should be satisfied through the suitability and appropriateness assessment tools or questionnaires to be utilised by Regulated Persons.

Client Agreement

Regulated Persons are required to enter into an agreement with clients prior to the provision of a service. The requirement of having a written (or equivalent) agreement between Regulated Persons and Clients is considered to be important in providing a high level of legal certainty. In fact, although until now Regulated Persons were not required to enter into a written (or equivalent) agreement with Professional clients, this was nevertheless a common practice adopted on the market.

The Section in the draft Rulbook relating to Clients' Agreement deals with the requirement for Regulated Persons to keep a record including the document or documents agreed between the Regulated Person and the Client setting out the rights and obligations of the parties, as well as any other terms on which the Regulated Person will provide services to the client. The Rules also set out a requirement for Regulated Persons who provide an investment service or certain specific ancillary services to both Retail and Professional Clients, to enter in a written basic agreement, in paper or another durable medium, which agreement should set out the essential rights and obligations of the Regulated Person and the Client to whom such service is being provided. This requirement has also been extended to Regulated Persons offering Advice, however only when such Regulated Person provides a periodic assessment of the suitability of the Financial instrument or Service being recommended to the Client.

Section 2: Execution of Clients' Orders

Application

The proposed Rules relating to execution of Clients' orders are mainly addressed to investment services licence holders, although the Rules also cater for certain rules which are applicable only to investment firms and other rules which are exclusively applicable to UCITS management companies, in view of the varying nature of the services offered by the Regulated Persons. The general overarching principle that a Regulated Person shall at all times carry out its activities honestly, professionally and in accordance with the best interests of the clients, shall apply to all Regulated Persons to whom this Rulebook is addressed. Most of the Rules under this chapter transpose existing rules and guidelines, with the addition of some requirements emanating from MiFID II and the proposed implementing measures.

Obligation to execute orders on terms most favourable to the client

A Regulated Person who executes client orders is required to take all reasonable steps to obtain the best possible result for its clients whilst taking into account the best execution factors of price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. The same rule applies to a UCITS management company with respect to the UCITS scheme it manages, when executing decisions to deal on its behalf in the context of its portfolio management.

Order Execution Policy

In order to comply with the general requirement referred to above, a Regulated Person is required to establish and implement effective execution arrangements, namely through the implementation of an order execution policy.

The proposed Rules set out the general requirements to be covered by the order execution policy, some of which are specific to the type of services being provided by the Regulated Person. Furthermore, the Rules also require that the order execution policy be periodically reviewed.

Client Order Handling Rules

The proposed Rules lay down requirements relating to the manner in which a Regulated Person is expected to deal with client order handling. These Rules relate mainly to the procedures and arrangements which a Regulated Person is required to have in place to ensure the prompt, fair and expeditious execution of Client orders, as well as Rules relating to the aggregation of Client or UCITS orders. Most of these Rules are effectively a transposition of existing Rules emanating from the relevant EU Directives and implementing measures.

Reporting Obligations

The proposed Rules in this Chapter also deal with the reporting obligations incumbent on Regulated Persons in relation to any material changes to their order execution arrangements or order execution policy. These also vary in accordance with the type of service being provided by the Regulated Person.

Organisational Requirements

The proposed Rules covering specific organisational requirements to be satisfied by Regulated Persons are sourced from existent Investment Services Rules, but are also supplemented by a number of additional Rules largely based on ESMA's draft implementing measures which will eventually amend the existing MiFID Implementing Directive. These new Rules mostly relate to record-keeping requirements. The Rules further emphasize that the requirements relating to policies and procedures in relation to record-keeping are in addition to any other requirements emanating from other EU Directives such as MiFID II, MiFIR, MAD and MAR.