MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Circular regarding the EU Capital Requirements Directive ("CRD")

7th May 2008

This Circular is being addressed to Investment Services Licence Holders and their auditors.

CRD Pillar I requirements on consolidated supervision

On the 14th March, 2008 the MFSA issued a consultation document dealing with the draft amendments to the Investment Services Rules for Investment Services Providers ['the draft Rules'] which have the purpose of transposing the CRD Pillar I requirements on consolidated supervision. By virtue of the said consultation document the Authority gave Investment Services Licence Holders and their auditors the opportunity to comment on the draft Rules. No feedback/comments were received by the Authority in this regard.

The Authority has finalised the draft Rules and is, by way of this circular, publishing the Investment Services Rules for Investment Services Providers as amended to transpose the CRD Pillar I requirements on consolidated supervision. A copy of: **[a]** Part B of the Investment Services Rules for Investment Services Providers incorporating an updated Section 7; **[b]** the new Appendix 3 A – and **[c]** the new Appendix 3 B – Financial Return for consolidations are attached to this circular.

A copy of the complete Rule book will be available shortly on the MFSA's website by selecting: *Securities / Investment Services / Rules for Investment Services Providers & related Guidance Notes / Part B - Standard Licence Conditions.*

The amendments to the Rules which have the purpose of transposing the CRD Pillar I requirements on consolidated supervision shall be applicable as from the date of the Investment Services Licence Holder's next financial year end.

Proposed changes to the CRD

On the 16th April, 2008 the European Commission issued a consultation document on possible changes to the CRD (*directives 2006/48/EC and 2006/49/EC*). In a press release (IP/08/583) issued on the same day, the European Commission explained that this consultation is being made in the context of on-going work related to the CRD at

various supervisory fora and that the review of the CRD is, in part, also a response to the recent recommendations of the G7 Financial Stability Forum.

The changes which are bring proposed relate to: **[i]** large exposures; **[ii]** hybrid capital instruments; **[iii]** supervisory arrangements; **[iv]** waivers for co-operative banks organised in networks; and **[v]** adjustments to certain technical provisions. The suggested measures concerning large exposures; hybrid capital instruments and the adjustments to the technical provisions are largely based on advice from the Committee of European Banking Supervisors.

The MFSA strongly encourages Investment Services Licence Holders to review and consider the proposed changes to the CRD, and to communicate their responses directly to the European Commission on the following e-mail address: markt-crd2008-survey@ec.europa.eu. The deadline for contributions is the 16th June, 2008.

All contributions will be published on the following web-site http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/cross-sector_issues&vm=detailed&sb=Title unless the respondent indicates that the contribution is to be treated confidentially. A summary of responses will be published on the same web-site at the end of June 2008.

Contacts

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INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

PART B: STANDARD LICENCE CONDITIONS

1. General Requirements

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

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

1.02 The Licence Holder shall co-operate in an open and honest manner with the MFSA and inform it promptly of any relevant information. The Licence Holder shall supply the MFSA with such information and returns as the MFSA requires.

1.03 Where a Standard Licence Condition demands that a Licence Holder notifies the MFSA of an event, such notification shall be made to the MFSA formally, in a durable medium. The request to notify the MFSA of an event shall not be satisfied merely by the fact that the information which ought to be notified to the MFSA is included in a standard regulatory return.

1.04 The Licence Holder's Investment Services Business shall be effectively directed or managed by at least two individuals in satisfaction of the "dual control" principle. Such persons shall be of sufficiently good repute and sufficiently experienced so as to ensure the sound and prudent management of the Licence Holder.

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

1.05 By way of derogation from the requirements of SLC 1.04, where a Licence Holder is a natural person or a legal person managed by a single natural person, it shall provide, to the satisfaction of MFSA, alternative arrangements which ensure that it is soundly and prudently managed.

1.06 The Licence Holder shall notify the MFSA in writing of:

a. a change in the Licence Holder's name or business name (if different) at least one month in advance of the change being made.

b. a change of address: at least one month in advance.

c. the departure of a Director or Senior Manager: within 14 days of the departure. The Licence Holder shall also request the Director or Senior Manager to confirm to MFSA that their departure had no regulatory implications or to provide relevant details, as appropriate. A copy of such request shall be provided to MFSA together with the Licence Holder's notification of departure.

d. the ultimate beneficial ownership of any party directly or indirectly controlling 10 per cent or more of the Licence Holder's share capital on becoming aware of the situation.

e. any acquisitions or disposals of shares which fall within the disclosure provisions of Article 10 of the Act – immediately upon becoming aware of the proposed acquisition or disposal. It should be noted that MFSA has the right to object to such an acquisition.

f. the provision of a related company loan, within 15 days of making the loan; provided that Licence Holder which falls under any one of the following categories need not comply with this requirements:

   i. credit institutions licensed in terms of the Banking Act, 1994; or

   ii. financial institutions licensed in terms of the Financial Institutions Act, 1994.

g. any proposed material change to its business (whether that business constitutes licensable activity under the Act or not) – at least one month before the change is to take effect (where a new or amended Investment Services Licence is required, the new business shall not begin until the new Investment Services Licence has been granted or the amendment has been approved).

h. any evidence of fraud or dishonesty by a member of the Licence Holder's staff immediately upon becoming aware of the matter.

i. a decision to make a material claim on any insurance policy held in relation to the Licence Holder's Investment Services business. Notification should be provided as soon as the decision is taken.

j. any actual or intended legal proceedings of a material nature by or against the Licence Holder immediately after the decision has been taken or on becoming aware of the matter.

k. any material changes in the information supplied to the MFSA – immediately upon becoming aware of the matter. This shall include the obligation to notify the MFSA on a continuous basis of any changes or circumstances which give rise to the existence of close links, as defined in Appendix 9, between the Licence Holder and any other person.

l. the fact, where applicable, that it has not provided any Investment Service or carried out any investment activity for the preceding six months, setting out the reasons for such inactivity and providing a business plan for future activity.

m. the relevant details required in terms of SLC 2.133 of these Rules pertaining to any introducers which may be appointed by the Licence Holder.

n. the proposed appointment of a Tied Agent and of any information required in terms of these Rules, pertaining to a Licence Holder appointing tied agents.

o. any other material information concerning the Licence Holder, its business or its staff in Malta or abroad – immediately upon becoming aware of the matter.

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

a. making any change to its share capital or the rights of its shareholders.

b. establishing a branch in Malta or abroad.

c. acquiring 10 per cent or more of the voting share capital of another company.

d. taking any steps to cease its Investment Services business.

e. agreeing to sell or merge the whole or any part of its undertaking.

f. making application to a Regulator abroad to undertake any form of licensable activity outside Malta.

g. the appointment of a Director or Senior Manager responsible for the Investment Services business of the Licence Holder or of the Licence Holder's Compliance Officer in terms of SLC 1.22(b) and/ or Money Laundering Reporting Officer, at least twenty one business days in advance. The request for consent of the appointment shall be accompanied by a Personal Questionnaire ("PQ"), in the form set out in Schedule F of these Rules – duly completed by the person proposed, which shall in the case of a proposed

Compliance Officer and/ or Money Laundering Reporting Officer, include sufficient details of the individual's background, training and/ or experience relevant to the post, to enable an adequate assessment by the MFSA. Where the person proposed had within the previous three years submitted a PQ to the MFSA in connection with some other role with the same Licence Holder, the request for consent need not be accompanied by a new PQ. In such instances, it shall be accompanied by a confirmation by the proposed person as to whether the information included in the PQ previously submitted is still current, and indicating any changes or up-dates thereto.

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

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

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

i. any persons, whether Directors, Senior Managers or other employees are engaged in any of the following activities:

- Portfolio or fund management

- Investment advice

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

1.08 The Licence Holder shall maintain sufficient records to be able to demonstrate

compliance with the conditions of its Investment Services Licence and as required by SLCs 2.83 to 2.85.

1.09 The Licence Holder shall co-operate fully with any inspection or other enquiry, or compliance testing carried out by the MFSA, or an inspector acting on its behalf.

1.10 Where, in the event of a dispute between a Licence Holder and a customer, it can be shown that unsuccessful efforts have been made to resolve the dispute, the MFSA may encourage the parties to submit the matter to arbitration. In such circumstances, the parties must in advance and in writing agree to:

a. make all the necessary arrangements at their own cost;

b. appoint as Arbitrator(s), person(s) mutually acceptable; and

c. be bound by the decision of the Arbitrator(s) as if such decision was a judgment of the Court.

Alternatively, the matter may have to be referred to the Courts.

1.11 The Licence Holder shall pay promptly all amounts due to the MFSA.

1.12 The Licence Fee shall be payable by the Licence Holder on the day the Licence is first issued, and thereafter annually within one week from the anniversary of that date.

1.13 The Licence Holder shall notify the MFSA of any breach of the conditions of the Licence as soon as the Licence Holder becomes aware of the breach.

1.14 If so required by the MFSA, the Licence Holder shall do all in its power to delay the cessation of its Investment Services business, or the winding-up of such business so as to comply with conditions imposed by the MFSA, in order to protect the interests of customers.

1.15 A request for a variation of a Licence by the Licence Holder shall be submitted to the MFSA in writing, giving details of the variation requested and the reasons therefore.

1.16 A Licence Holder which is a sole trader or a small business shall make arrangements to ensure that customers' interests are safeguarded in the event of death, incapacity, sickness, holidays or other absence of the licensee.

General Organisational Requirements

1.17 The Licence Holder shall:

a. establish, implement and maintain decision-making procedures and an organisational structure which clearly and in a documented manner specifies reporting lines and allocates functions and responsibilities;

b. ensure that its relevant persons are aware of the procedures which must be followed for the proper discharge of their responsibilities;

c. establish, implement and maintain adequate internal control mechanisms designed to secure compliance with decisions and procedures at all levels of the Licence Holder;

d. employ personnel with the skills, knowledge and expertise necessary for the discharge of responsibilities allocated to them;

e. establish, implement and maintain effective internal reporting and communication of information at all relevant levels of the Licence Holder;

f. maintain adequate and orderly records of its business and internal organisation;

g. ensure that the performance of multiple functions by its relevant persons does not and is not likely to prevent those persons from discharging any particular function soundly, honestly and professionally.

For these purposes, the Licence Holder shall take into account the nature, scale and complexity of its business, and the nature and range of Investment and Ancillary Services undertaken in the course of that business.

1.18 The Licence Holder shall establish, implement and maintain:

a. systems and procedures that are adequate to safeguard the security, integrity and confidentiality of information, taking into account the nature of the information in question;

b. an adequate business continuity policy aimed at ensuring, in the case of an interruption to its systems and procedures, the preservation of essential data and functions and the maintenance of Investment Services and activities, or, where that is not possible, the timely recovery of such data and functions and the timely resumption of its Investment Services and related activities;

c. accounting policies and procedures that enable it to deliver in a timely manner to the MFSA upon request, financial reports which reflect a true and fair view of its financial position and which comply with all applicable accounting standards and rules.

1.19 The Licence Holder shall monitor and, on a regular basis evaluate, the adequacy and

effectiveness of its systems, internal control mechanisms and arrangements established in accordance with SLCs 1.17 and 1.18 above and take appropriate measures to address any deficiencies.

Compliance

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

The Licence Holder shall, for this purpose, take into account the nature, scale and complexity of its business and the nature and range of Investment Services and activities undertaken in the course of that business

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

a. to monitor and, on a regular basis, to assess the adequacy and effectiveness of the measures and procedures put in place in accordance with the requirements of SLC 1.20, and the actions taken to address any deficiencies in the Licence Holder's compliance with its obligations;

b. to advise and assist the relevant persons responsible for carrying out Investment Services and activities to comply with the Licence Holder's legal and regulatory obligations.

1.22 In order to enable the compliance function to discharge its responsibilities properly, the Licence Holder shall ensure that the following conditions are satisfied:

a. the compliance function shall have the necessary authority, resources, expertise and access to all relevant information;

b. a Compliance Officer shall be appointed and shall be responsible for the compliance function and for any reporting as to compliance required by these Rules;

c. the relevant persons involved in the compliance function shall not be involved in the performance of services or activities which they monitor;

d. the method of determining the remuneration of the relevant persons involved in the compliance function shall not compromise their objectivity and shall not be likely to do so.

However, MFSA may exempt a Licence Holder from the requirements of points (c) or (d) if the Licence Holder is able to demonstrate to the satisfaction of the MFSA, that in view of the nature, scale and complexity of its business, and the nature and range of Investment Services and related activities, the requirement under that point is not proportionate and that its compliance function continues to be effective.

Moreover, with respect to (b) above, the appointment of an individual as Compliance Officer, is subject to MFSA's prior approval. Such person may also act as the Licence Holder's Money Laundering Reporting Officer. Reference should be made to SLC 1.07 (g) in this regard.

Risk Management

1.23 The Licence Holder shall take the following actions with a view to manage its risks:

a. establish, implement and maintain adequate risk management policies and procedures which identify the risks relating to the Licence Holder's activities, processes and systems, and where appropriate, set the level of risk tolerated by the Licence Holder;

b. adopt effective arrangements, processes and mechanisms to manage the risks relating to the Licence Holder's activities, processes and systems, in light of that level of risk tolerance;

c. monitor the following:

i. the adequacy and effectiveness of the Licence Holder's risk management policies and procedures;

ii. the level of compliance by the Licence Holder and its relevant persons with the arrangements, processes and mechanisms adopted in accordance with point (b) above;

iii. the adequacy and effectiveness of measures taken to address any deficiencies in those arrangements and procedures, including failures by the relevant persons to comply with such arrangements or follow such procedures.

1.24 The Licence Holder is required to establish and maintain a risk management function that operates independently and carries out the following tasks:

a. the implementation of the policy and procedures referred to in SLC1.23; and

b. the provision of reports and advice to senior management in accordance with SLC 1.26.

However, MFSA may allow the Licence Holder to establish and maintain a risk management function which does not operate independently if the Licence Holder, satisfies the MFSA that the establishment and maintenance of an independent risk management function is not appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of the Investment Services and activities undertaken in the course of that business.

Where a Licence Holder is granted such a derogation, it must nevertheless be able to demonstrate that the policies and procedures which it has adopted in accordance with SLC 1.23, satisfy the requirements thereof and are consistently effective.

Responsibility of Senior Management

1.25 When allocating functions internally, the Licence Holder shall ensure that senior management, and where appropriate, the supervisory function, are responsible for ensuring that the Licence Holder complies with its obligations under these Rules.

In particular, senior management and where appropriate, the supervisory function shall be required to assess and periodically to review the effectiveness of the policies, arrangements and procedures put in place to comply with the obligations under these Rules and to take appropriate measures to address any deficiencies.

1.26 The Licence Holder shall ensure that its senior management receives on a frequent basis, and at least annually, written reports on the matters covered by SLCs1.20 to 1.24 and SLC 1.28 indicating in particular whether the appropriate remedial measures have been taken in the event of any deficiencies.

1.27 The Licence Holder shall ensure that the supervisory function, if any, receives on a regular basis (at least annually) written reports on the same matters.

For the purposes of this Section, "supervisory function" means the function within a Licence Holder responsible for the supervision of its senior management.

Internal Audit

1.28 Where appropriate and proportionate in view of the nature, scale and complexity of its business and the nature and range of investments services and activities undertaken in the course of its business, the Licence Holder shall establish and maintain an internal audit function which is separate and independent from the other functions and activities of the Licence Holder and which has the following

responsibilities:

a. to establish, implement and maintain an audit plan to examine and evaluate the adequacy and effectiveness of the Licence Holder's systems, internal control mechanisms and arrangements;

b. to issue recommendations based on the result of work carried out in accordance with point (a);

c. to verify compliance with those recommendations;

d. to report in relation to internal audit matters in accordance with SLC1.26.

Enforcement

1.29 The Licence Holder shall at all times observe the Licence Conditions which are applicable to it, as well as all the relative requirements which emanate from the Act and regulations issued thereunder. In terms of the Act, the MFSA has various sanctioning powers which may be used against the Licence Holder which does not comply with its regulatory obligations. Such powers include the right to impose administrative penalties. Appendix 5 to these Rules refers to the factors which the MFSA takes into account when imposing administrative penalties and includes – for indicative purposes - non-exhaustive details of the penalties applicable for breaches of certain Licence Conditions and for late submission of documents and licence fees.

2. Conduct of Business Obligations

General

2.01 When providing Investment Services to clients, a Licence Holder shall act honestly, fairly and professionally in accordance with the best interests of its clients and shall comply with the relevant provisions of the Act, the Regulations issued thereunder, these Rules as well as with other relevant legal and regulatory requirements, in particular those set out in the Prevention of Money Laundering Act, 1994, and the Prevention of Financial Markets Abuse Act, 2005 and Regulations issued thereunder. The Licence Holder is also expected to take due account of any relevant Guidance Notes which may be issued by the MFSA or other relevant body to assist the Licence Holder in complying with its legal and regulatory obligations.

2.02 The Licence Holder shall not be regarded as acting honestly, fairly and professionally in accordance with the best interests of a client if, in relation to the provision of an investment or Ancillary Service to the client, it pays or is paid any fee or commission, or provides or is provided with any non-monetary benefit, other than the following:

a. a fee, commission or non-monetary benefit paid or provided to or by the client or a person on behalf of the client;

b. a fee, commission or non-monetary benefit paid or provided to or by a third party or a person acting on behalf of a third party, where the following conditions are satisfied:

i. the existence, nature and amount of the fee, commission or benefit, or where the amount cannot be ascertained, the method of calculating that amount, must be clearly disclosed to the client, in a manner that is comprehensive, accurate and understandable, prior to the provision of the relevant Investment or Ancillary Service. The essential terms of the arrangements relating to the fee, commission or non-monetary benefit may be disclosed in summary form, provided that the Licence Holder undertakes to disclose further details at the request of the client and provided that it honours that undertaking;

ii. the payment of the fee or commission, or the provision of the non-monetary benefit must be designed to enhance the quality of the relevant Investment or Ancillary Service to the client and not impair compliance with the Licence Holder's duty to act in the best interests of the client;

c. proper fees which enable or are necessary for the provision of Investment Services such as custody costs, settlement and exchange fees, regulatory levies

or legal fees, and which, by their nature, cannot give rise to conflicts with the Licence Holder's duties to act honestly, fairly and professionally in accordance with the best interests of its clients.

Client Classification

2.03 Before providing an Investment Service, the Licence Holder shall classify the client or potential client to whom the service is to be offered as a Professional Client, Retail Client or an Eligible Counterparty in terms of the Glossary to these Rules and the following Rules.

Moreover, the Licence Holder shall notify new clients and existing clients which it has newly categorised, of their categorisation as a Retail Client, a Professional Client or Eligible Counterparty.

2.04 The Licence Holder shall implement appropriate written internal policies and procedures to categorise clients. Professional Clients are responsible for keeping the Licence Holder informed about any change, which could affect their current categorisation. Should the Licence Holder become aware however that the client no longer fulfils the initial conditions, which made him/her eligible for a professional treatment, the Licence Holder must take appropriate action.

2.05 The Licence Holder shall inform clients in a durable medium about any right that a client has to request a different categorisation and about any limitations to the level of client protection it would entail.

2.06 The Licenec Holder may, either on its own initiative or at the request of the client concerned:

a. treat as a professional or Retail Client, a client that might otherwise be classified as an Eligible Counterparty;

b. treat as a Retail Client, a client that is considered as a Professional Client as defined in the Glossary to these Rules.

2.07 Where a client would ordinarily fall within the definition of a Professional Client, it may still elect to be treated as a Retail Client and the Licence Holder may agree to provide a higher level of protection. In this case, the Licence Holder must:

a. warn the client, prior to any provision of services, that, on the basis of the information available to it, the client is deemed to be a Professional Client, and will be treated as such unless Licence Holder and the client agree otherwise;

b. inform the client that he can request a variation of the terms of the agreement in order to secure a higher degree of protection.

Although it is the responsibility of the client, considered to be a Professional Client, to ask for a higher level of protection when he/she deems he/she is unable to properly assess or manage the risks involved, such higher level of protection will only be provided on the basis of a written agreement with the Licence Holder to the effect that the client shall not be treated as a Professional Client for the purposes of the applicable Conduct of Business Rules. Such agreement should specify whether this applies to one or more particular services or transactions, or to one or more types of product or transaction.

2.08 The Licence Holder shall treat clients which do not fall under the definition of a Professional Client in terms of the Glossary to these Rules, including public sector bodies and private individual investors, as Retail Clients, unless they have clearly elected not to be so treated. Such an option would mean that the client has chosen to waive some of the protections afforded by the Conduct of Business Rules and the Licence Holder shall only uphold such a request provided the relevant criteria and procedure mentioned below in SLC 2.09 to 2.12, are fulfilled.

2.09 Such clients referred to in SLC 2.08 which have opted not to be treated as Retail Clients, should not be presumed to possess market knowledge and experience comparable to that of the categories mentioned in the definition of Professional Clients. Any waiver of the protection afforded by the standard Conduct of Business Rules shall be considered valid only if an adequate assessment of the expertise, experience and knowledge of the client, undertaken by the Licence Holder, gives reasonable assurance, in the light of the nature of the transactions or services envisaged, that the client is capable of making his own investment decisions and of understanding the risks involved.

2.10 In the course of the above assessment required in terms of SLC 2.09, as a minimum, two of the following criteria should be satisfied:

a. the client has carried out transactions, in significant size, on the relevant market at an average frequency of 10 per quarter of the previous four quarters;

b. The size of the client's Instrument portfolio, defined as including cash deposits and Instruments exceeds EUR 500 000;

c. The client works or has worked in the financial sector for at least one year in a professional position, which requires knowledge of the transactions or services envisaged.

2.11 Clients referred to in SLC 2.08, may waive the benefit of the Conduct of Business Rules only where the following procedure is followed:

a. they must state in writing to the Licence Holder that they wish to be treated as

a Professional Client, either generally or in respect of a particular Investment Service or transaction or type of transaction or product

b. the Licence Holder must give them a clear written warning of the protections and investor compensation rights they may lose

c. they must state in writing in a separate document from the contract, that they are aware of the consequences of losing such protections.

2.12 Before deciding to accept any request for waiver, the Licence Holder is required to take all reasonable steps to ensure that the client requesting to be treated as a Professional Client meets the relevant requirements stated in SLC 2.10 above. However, if clients have already been categorised as professionals under parameters and procedures similar to those above, it is not intended that their relationships with the Licence Holder should be affected by any new procedures adopted under these Rules.

Client Profile Requirements

Assessment of Suitability and Appropriateness

2.13 When providing investment advice or portfolio management services, the Licence Holder shall obtain the necessary information, in accordance with SLCs 2.16 to 2.20 and SLC 2.22 to 2.24 regarding the client's or potential client's knowledge and experience in the investment field relevant to the specific type of product or service, his financial situation and his investment objectives so as to enable the Licence Holder to recommend to or, in the case of portfolio management, to effect for the client or potential client, the Investment Services and Instruments that are suitable for him.

2.14 When providing Investment Services other than investment advice or portfolio management services, the Licence Holder shall ask the client or potential client to provide information in accordance with SLCs 2.21 and SLC 2.22 to 2.24 regarding his knowledge and experience in the investment field relevant to the specific type of product or service offered or demanded so as to enable the Licence Holder to assess whether the Investment Service or product envisaged is appropriate for the client.

In case the Licence Holder considers, on the basis of the information received under the above paragraph, that the product or service is not appropriate to the client or potential client, the Licence Holder shall warn the client or potential client. This warning may be provided in a standardised format.

In case where the client or potential client elects not to provide the information referred in this SLC or where he provides insufficient information regarding his knowledge and experience, the Licence Holder shall warn the client or potential

client that such a decision will not allow the Licence Holder to determine whether the service or product envisaged is appropriate for him. This warning may be provided in standardised format.

2.15 In cases where an Investment Service is offered as part of a financial product which is already subject to other provisions of Community legislation or common European standards related to credit institutions and consumer credits with respect to risk assessment of clients and/or information requirements, this service shall not be additionally subject to the obligations set out in this Section.

Assessment of Suitability

2.16 The Licence Holder shall obtain from clients or potential clients, such information as is necessary for the Licence Holder to understand the essential facts about the client and to have a reasonable basis for believing, giving due consideration to the nature and extent of the service provided, that the specific transaction to be recommended, or entered into in the course of providing a portfolio management service, satisfies the following criteria:

a. it meets the investment objectives of the client in question;

b. it is such that the client is able financially to bear any related investment risks consistent with his investment objectives;

c. it is such that the client has the necessary experience and knowledge in order to understand the risks involved in the transaction or in the management of his portfolio.

2.17 Where a Licence Holder provides an Investment Service to a Professional Client, it shall be entitled to assume that, in relation to the products, transactions and services for which it is so classified, the client has the necessary level of experience and knowledge for the purposes of SLC 2.16.

Where that Investment Service consists in the provision of investment advice to a Professional Client, the Licence Holder shall be entitled to assume for the purposes of SLC 2.16 that the client is able financially to bear any related investment risks consistent with the investment objectives of that client.

2.18 The information regarding the financial situation of the client or potential client shall include, where relevant, information on the source and extent of his regular income, his assets, including liquid assets investments and real property, and his regular financial commitments.

2.19 The information regarding the investment objectives of the client or potential client shall include, where relevant, information on the length of time for which the client

wishes to hold the investment, his preferences regarding risk taking, his risk profile and the purposes of the investment.

2.20 Where, when providing the Investment Service of investment advice or portfolio management, a Licence Holder does not obtain the information required under SLC 2.13, the Licence Holder shall refrain from providing the above mentioned services to the client or potential client.

Assessment of appropriateness

2.21 When assessing whether an Investment Service, other than investment advice or portfolio management, is appropriate for a client, the Licence Holder shall be required to determine whether that client has the necessary experience and knowledge in order to understand the risks involved in relation to the product or Investment Service offered or demanded.

For these purposes, a Licence Holder shall be entitled to assume that a Professional Client has the necessary experience and knowledge in order to understand the risks involved in relation to those particular Investment Services or transactions, or types of transaction or product, for which the client is classified as a Professional Client.

Provisions common to the assessment of suitability and appropriateness.

2.22 Information regarding the client's or potential client's knowledge and experience in the investment field includes the following, to the extent appropriate to the nature of the client, the nature and extent of the service to be provided and the type of product or transaction envisaged, including their complexity and the risks involved:

a. the types of service, transaction and Instrument with which the client is familiar;

b. the nature, volume, frequency of the client's transactions in Instruments and the period over which they have been carried out;

c. the level of education, profession or relevant former profession of the client or potential client.

2.23 A Licence Holder shall not encourage a client or potential client not to provide information required for the purposes of SLCs 2.13 and 2.14.

2.24 A Licence Holder shall be entitled to rely on the information provided by its clients or potential clients unless it is aware or ought to be aware that the information is manifestly out of date, inaccurate or incomplete.

Exemption from the Appropriateness Test

2.25 When providing Investment Services that only consist of the execution and/or reception and transmission of client orders with or without Ancillary Services, the Licence Holder need not obtain the information referred to in SLC 2.14 above where all of the following conditions are met:

a. the above services relate to shares admitted to trading on a regulated market or in an equivalent third country market, money market Instruments, bonds or other forms of securitised debt (excluding those bonds or securitised debt that embed a derivative), UCITS and other non-complex Instruments. A market established in a country which is not an EU or EEA Member State shall be considered as equivalent to a regulated market if it complies with equivalent requirements to those established in terms of the MIFID;

b. the service is provided at the initiative of the client or potential client;

c. the client or potential client has been clearly informed that in the provision of this service the Licence Holder is not required to assess the suitability of the Instrument or service provided or offered and that therefore, he does not benefit from the corresponding protection of the relevant Conduct of Business Rules. This warning may be provided in standardised format;

d. the Licence Holder complies with its obligations relating to the management of conflicts of interests as set out in SLC 2.94 to 2.100. below.

2.26 An Instrument which is not specified in SLC 2.25(a) above shall be considered as non-complex if it satisfies the following criteria:

a. It does not fall under paragraph (c) of the definition of "transferable securities" in the Glossary to these Rules or under paragraphs (4) to (10) of the Second Schedule to the Act;

b. there are frequent opportunities to dispose of, redeem, or otherwise realise that Instrument at prices that are publicly available to market participants and that are either market prices or prices made available, or validated, by valuation systems independent of the issuer;

c. it does not involve any actual or potential liability for the client that exceeds the cost of acquiring the Instrument;

d. adequately comprehensive information on its characteristics is publicly available and is likely to be readily understood so as to enable the average Retail Client to make an informed judgment as to whether to enter into a transaction in that Instrument.

Client Disclosure Requirements

2.27 The Licence Holder shall provide appropriate information, in a comprehensible form to its clients or potential clients such that they are reasonably able to understand the nature and risks of the Investment Service to be provided by the Licence Holder and of the specific type of Instrument that is being offered, and consequently to take investment decisions on an informed basis. This information may be provided in standardized format and should include details about:

a. the Licence Holder and its services;

b. Instruments and proposed investment strategies. This should include appropriate guidance on and warnings of the risks associated with investments in those Instruments or in respect of particular investment strategies;

c. execution venues;

d. costs and associated charges.

2.28 The Licence Holde shall provide Retail Clients or potential Retail Clients with the following general information, where relevant:

a. the name and address of the Licence Holder, and the contact details necessary to enable clients to communicate effectively with the Licence Holder;

b. the languages in which the client may communicate with the Licence Holder, and receive documents and other information from the Licence Holder;

c. the methods of communication to be used between the Licence Holder and the client including, where relevant, those for the sending and reception of orders;

d. a statement of the fact that the Licence Holder is licensed by the MFSA, together with the address of the MFSA;

e. the nature, frequency and timing of the reports on the performance of the service to be provided by the Licence Holder to the client in accordance with SLC 2.40;

f. if the Licence Holder holds client Instruments or client money, a summary description of the steps which it takes to ensure their protection, including summary details of any relevant investor compensation or deposit guarantee scheme which applies to the Licence Holder by virtue of its activities in a Member State;

g. a description, which may be provided in summary form, of the conflicts of interest policy maintained by the Licence Holder in according with SLC 2.98 to 2.100;

h. at any time that the client requests it, further details of that conflicts of interest policy in a durable medium or by means of a website (where that does not constitute a durable medium) provided that the conditions specified in SLC 2.115 are satisfied.

2.29 When providing the services of portfolio management, the Licence Holder shall establish an appropriate method of evaluation and comparison such as a meaningful benchmark, based on the investment objectives of the client and types of Instruments included in the client portfolio, so as to enable the client for whom the service is provided to assess the Licence Holder's performance.

2.30 The following information shall also be provided, where applicable, in addition to that required under SLC 2.28 to Retail Clients or potential Retail Clients by the Licence Holder proposing to provide portfolio management services:

a. information on the method and frequency of valuation of the Instruments in the client portfolio;

b. details of any delegation of the discretionary management of all or part of the Instruments or money in the client's portfolio;

c. a specification of any benchmark against which the performance of the client portfolio will be compared;

d. the types of Instrument that may be included in the client's portfolio and types of transaction that may be carried out in such Instruments, including any limits;

e. the management objectives, the level of risk to be reflected in the Licence Holder's exercise of discretion, and any specific constraints on that discretion.

2.31 The Licence Holder shall, in good time before a Retail Client or potential Retail Client is bound by any agreement for the provision of Investment Services or Ancillary Services or before the provision of those services whichever is the earlier, to provide that client or potential client with the following information:

a. the terms of any such agreement;

b. the information required in SLC 2.28 to 2.30 relating to that agreement or to those Investment or Ancillary Services.

2.32 The Licence Holder, shall, in good time before the provision of Investment Services

or Ancillary Services to Retail Clients or potential Retail Clients, provide the information required under SLCs 2.28 to 2.30 and SLCs 3.10 to 3.22.

2.33 The Licence Holder shall provide Professional Clients with the information referred to in SLCs 3.19 to 3.20 in good time before the provision of the service concerned.

2.34 The information referred to in SLCs 2.31 to 2.33 shall be provided in a durable medium or by means of a website (where that does not constitute a durable medium) provided that the conditions in SLC 2.115 are satisfied[1].

2.35 By way of exception from SLCs 2.31 and 2.32, the Licence Holder may, in the following circumstances provide the information required under SLC 2.31 to a Retail Client immediately after that client is bound by any agreement for the provision of Investment Services or Ancillary Services, and the information required under SLC 2.32 immediately after starting to provide the service:

a. the Licence Holder was unable to comply with the time-limits specified in SLCs 2.31 and 2.32 because, at the request of the client, the agreement was concluded using a means of distance communication which prevents the Licence Holder from providing the information required in the aforementioned SLCs;

b. in any case where Article 3(3) of Directive 2002/65/EC on the distance marketing of consumer financial services does not otherwise apply, the Licence Holder complies with the requirement in relation to the retail investor or potential retail investor, as if that client or potential client were a "consumer" and the Licence Holder were a "supplier" within the meaning of that Directive.

2.36 The Licence Holder shall notify a client in good time about any material change to the information provided under SLCs 2.28 to 2.30 and 3.10 to 3.22 which is relevant to the service being provided to that client. That notification shall be given in a durable medium if the information to which it relates is given in a durable medium.

2.37 The Licence Holder shall ensure that information contained in a marketing communication, is consistent with any information the Licence Holder provides to clients in the course of carrying on Investment or Ancillary Services.

Retail Client Agreement

2.38 The Licence Holder shall establish a record that includes the document or documents agreed between it and the client and which set out the rights and obligations of the parties, and the other terms on which the Licence Holder will provide services to the

[1] Amended 16th November, 2007

client. The rights and duties of the parties to the contract may be incorporated by reference to other documents or legal texts.

2.39 The Licence Holder which provides an Investment Service other than investment advice to a new Retail Client, shall enter into a written basic agreement with the client, in paper or another durable medium, setting out the essential rights and obligations of the Licence Holder and the client.

The rights and duties of the parties to the agreement may be incorporated by reference to other documents or legal texts.

Client Reporting

General

2.40 The client must receive from the Licence Holder, adequate reports on the service provided to him. These reports shall include, where applicable, the costs associated with the transactions and services undertaken on behalf of the client.

Reporting Obligations in Respect of Execution of Orders Other Than For Portfolio Management

2.41 Where a Licence Holder has carried out an order, other than for portfolio management, on behalf of a client, it is required to take the following action in respect of that order:

a. it must promptly provide the client, in a durable medium, with the essential information concerning the execution of that order;

b. in the case of a Retail Client, it must send the client a notice in a durable medium confirming execution of the order as soon as possible and no later than the first business day following execution or, if the confirmation is received by the Licence Holder from a third party, no later than the first business day following receipt of the confirmation from the third party;

Point (b) shall not apply where the confirmation would contain the same information as a confirmation that is to be promptly dispatched to the Retail Client by another person.

Points (a) and (b) shall not apply where orders executed on behalf of clients relate to bonds funding mortgage loan agreements with the said clients, in which case the report on the transaction shall be made together with the consolidated terms of the mortgage loan, but no later than one month after the execution of the order.

2.42 In addition to the requirements set out above, the Licence Holder shall supply the

client, on request, with information about the status of his order.

2.43 In the case of orders for a Retail Client relating to units or shares in a collective investment scheme which are executed periodically, the Licence Holder shall either take the action specified in point (b) of SLC 2.41 or provide the Retail Client, at least once every six months, with the information listed in SLC 2.44 in respect of those transactions.

2.44 The notice referred to in point (b) of SLC 2.41 shall include such of the following information as is applicable, and where relevant, in accordance with Table 1 of Annex I to the Commission Regulation:

a. the reporting Licence Holder's identification;

b. the name or designation of the client;

c. the trading day;

d. the trading time;

e. the type of the order;

f. the venue identification;

g. the Instrument identification;

h. the buy/sell indicator;

i. the nature of the order if other than buy/sell

j. the quantity;

k. the unit price;

l. the total consideration;

m. a total sum of the commissions and expenses charged and, where the Retail Client so requests, an itemised breakdown;

n. the client's responsibilities in relation to the settlement of the transaction including the time limit for payment or delivery as well as the appropriate account details where these details and responsibilities have not previously been notified to the client;

o. if the client's counterparty was the Licence Holder itself or any person in the

Licence Holder's group or another client of the Licence Holder, the fact that this was the case unless the order was executed through a trading system that facilitates anonymous trading.

For the purposes of (k) above, where the order is executed in tranches, the Licence Holder may supply the client with information about the price of each tranche or the average price. Where the average price is provided, the Licence Holder shall supply the Retail Client with information about the price of each tranche upon request.

2.45 The Licence Holder may provide the client with the information referred to in SLC 2.44 using standard codes if it also provides an explanation of the codes used.

Reporting Obligations In Respect of Portfolio Management Services.

2.46 The Licence Holder which provide the service of portfolio management to clients shall provide each such client with a periodic statement in a durable medium of the portfolio management activities carried out on behalf of that client unless such a statement is provided by another person.

2.47 In the case of Retail Clients, the periodic statement required above shall include wherever relevant, the following information:

a. the name of the Licence Holder;

b. the name or other designation of the Retail Client's account;

c. a statement of the contents and the valuation of the portfolio, including details of each Instrument held, its market value, or fair value if market value is unavailable and the cash balance at the beginning and the end of the reporting period, and the performance of the portfolio during the reporting period;

d. the total amount of fees and charges incurred during the reporting period, itemising at least total management fees and total costs associated with execution, and including where relevant, a statement that a more detailed breakdown will be provided on request;

e. a comparison of performance during the period covered by the statement with the investment performance benchmark (if any) agreed between the Licence Holder and the client;

f. the total amount of dividends, interest and other payments received during the reporting period in relation to the client's portfolio;

g. Information about other corporate actions giving rights in relation to Instruments held in the portfolio;

h. For each transaction executed during the period, the information referred in SLC 2.44 where relevant, unless the client elects to receive information about executed transactions on a transaction – by- transaction basis, in which case SLC 2.49 shall apply.

2.48 In the case of Retail Clients, the periodic statement referred to in SLC 2.46 shall be provided once every six months, except in the following cases:

a. where the client so requests, the periodic statement must be provided every 3 months;

b. in cases where SLC 2.49 applies, the periodic statement must be provided at least once every 12 months;

c. where the agreement between a Licence Holder and a Retail Client for a portfolio management service authorises a leveraged portfolio, the periodic statement must be provided at least once a month.

The Licence Holder shall inform Retail Clients that they have the right to make requests for the purposes of point (a).

However the exception provided for in point (b) shall not apply in case of transactions in securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement determined by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures or in Instruments included in points (4) to (10) of the Second Schedule to the Act.

2.49 The Licence Holder shall, in cases where the client elects to receive information about executed transactions on a transaction-by-transaction basis, provide promptly to the client, on the execution of a transaction by the portfolio manager, the essential information concerning that transaction in a durable medium.

Where the client concerned is a Retail Client, the Licence Holder must send him a notice confirming the transaction and containing the information referred to in SLC 2.44 no later than the first business day following that execution or, if the confirmation is received by the Licence Holder from third party, no later than the first business day following sub-paragraph shall not apply where the confirmation would contain the same information as a confirmation that is to be promptly dispatched to the Retail Client by another person.

Additional Reporting Obligations For Portfolio Management or Contingent Liability Transactions.

2.50 Where a Licence Holder provides portfolio management transactions for Retail Clients or operates Retail Client accounts that include an uncovered open position in a contingent liability transaction, it is also required to report to the Retail Client any losses exceeding any predetermined threshold, agreed between the Licence Holder and the client, no later than the end of the business day in which the threshold is exceeded or, in a case where the threshold is exceeded on a non-business day, the close of the next business day.

Statement of Client Instruments or Client Money.

2.51 A Licence Holder that holds client Instruments or client money is required to send at least once a year, to each client for whom it holds Instruments or money, a statement in a durable medium of those Instruments or money unless such a statement has been provided in any other periodic statement.

Provided that this SLC shall not apply to a credit institution authorised under Directive 2000/12/EC, relating to the taking up and pursuit of the business of credit institutions, in respect of deposits within the meaning of that Directive held by that institution.

2.52 The statement of client assets referred to above, shall include the following information:

a. details of all the Instruments or money held by the Licence Holder for the client at the end of the period covered by the statement;

b. the extent to which any client Instruments or client money have been the subject of securities financing transactions;

c. the extent of any benefit that has accrued to the clients by virtue of participation in any securities financing transactions, and the basis on which that benefit has accrued.

In cases where the portfolio of a client includes the proceeds of one or more unsettled transactions, the information referred to in point (a) may be based either on the trade date or the settlement date, provided that the same basis is applied consistently to all such information in the statement.

2.53 A Licence Holder which holds Instruments or money and which carries out the service of portfolio management for a client, may include the statement of client assets referred to in SLC 2.52, in the periodic statement it provides to that client pursuant to SLC 2.46.

Best Execution Requirements

General

2.54 The Licence Holder shall take all reasonable steps to obtain, when executing orders, the best possible result for its clients taking into account price, costs, speed, likelihood of execution and settlement, size, nature or any other consideration relevant to the execution of the order. Nevertheless, whenever there is a specific instruction from the client, the Licence Holder shall execute the order following the specific instruction.

2.55 The Licence Holder shall establish and implement effective arrangements for complying with SLC 2.54. In particular, the Licence Holder shall establish and implement an order execution policy to allow it to obtain, for its client orders, the best possible result in accordance with SLC 2.54.

2.56 The order execution policy shall include in respect of each class of Instruments, information on the different venues where the Licence Holder executes its client orders and the factors affecting the choice of execution venue. It shall at least include those venues that enable the Licence Holder to obtain on a consistent basis the best possible result for the execution of client orders.

The Licence Holder shall provide appropriate information to its clients on its order execution policy and shall obtain the prior consent of its clients to the execution policy.

Where the order execution policy provides for the possibility that client orders may be executed outside a regulated market or a MTF, the Licence Holder shall, in particular, inform its clients about this possibility. The Licence Holder shall obtain the prior express consent of its clients before proceeding to execute their orders outside a regulated market or an MTF. The Licence Holder may obtain this consent either in the form of a general agreement or in respect of individual transactions.

2.57 The Licence Holder shall monitor the effectiveness of its order execution arrangements and execution policy in order to identify and, where appropriate, correct any deficiencies. In particular, it shall assess, on a regular basis, whether the execution venues included in the order execution policy provide for the best possible result for the client or whether it needs to make changes to its execution arrangements. The Licence Holder shall notify clients of any material changes to its order execution arrangements or execution policy.

2.58 The Licence Holder shall be able to demonstrate to its clients, at their request, that it has executed their orders in accordance with the Licence Holder's execution policy.

Best Execution Criteria

2.59 When executing client orders, the Licence Holder shall take into account the following criteria for determining the relative importance of the factors referred to in SLC 2.54:

a. the characteristics of the client including the categorisation of the client as retail or professional;

b. the characteristics of the client order;

c. the characteristics of Instruments that are the subject of that order;

d. the characteristics of the execution venues to which that order can be directed.

For the purpose of this SLC and SLCs 2.70 and 2.71, "execution venue" means a regulated market, an MTF, a systematic internaliser, or a market maker or other liquidity provider or an entity that performs a similar function in a third country to the functions performed by any of the foregoing.

2.60 A Licence Holder would satisfy its obligation under SLC 2.54 to take all reasonable steps to obtain the best possible result for a client to the extent that it executes an order or a specific aspect of the order following specific instructions from a client relating to the order or the specific aspect of the order.

2.61 Where a Licence Holder executes an order on behalf of a Retail Client, the best possible result shall be determined in terms of the total consideration, representing the price of the Instrument and the costs related to execution, which shall include all expenses incurred by the client which are directly related to the execution of the order, including execution venue fees, clearing and settlement fees and any other fees paid to third parties involved in the execution of the order.

For the purposes of delivering best execution where there is more than one competing venue to execute an order for an Instrument, in order to assess and compare the results for the client that would be achieved by executing the order on each of the execution venues listed in the Licence Holder's order execution policy that is capable of executing that order, the Licence Holder's 's own commissions and costs for executing the order on each of the eligible execution venues shall be taken into account in that assessment.

2.62 The Licence Holder shall not structure or charge its commission in such a way as to discriminate unfairly between execution venues.

Special Provisions Applicable to a Licence Holder Carrying Out Portfolio Management Services and Reception and Transmission of Orders.

2.63 When providing the service of portfolio management, the Licence Holder shall act in accordance with the best interests of its clients when placing orders with other entities for execution that result from decisions by the Licence Holder to deal in Instruments on behalf of its clients.

2.64 When providing the services of transmission and reception of orders (arranging deals), the Licence Holder shall comply with the obligation to act in accordance with the best interests of its clients when transmitting client orders, to other entities for execution.

2.65 In complying with SLCs 2.63 and 2.64 above, the Licence Holder shall comply with the requirements of SLC 2.66 to SLC 2.69.

2.66 The Licence Holder shall take all reasonable steps to obtain the best possible result for its clients taking into account the factors referred to in SLC 2.54 . The relative importance of these factors shall be determined by reference to the criteria set out in SLC 2.59 and, for Retail Clients, to the requirement under SLC 2.61.

A Licence Holder satisfies its obligations under SLC 2.63 or SLC 2.64, and is not required to take the steps mentioned in this Licence Condition, to the extent that it follows specific instructions from its client when placing an order with, or transmitting an order to, another entity for execution.

2.67 The Licence Holder shall establish and implement a policy to enable it to comply with the obligation in SLC 2.66. The policy shall identify, in respect of each class of Instruments, the entities with which the orders are placed or to which the Licence Holder transmits orders for execution. The entities identified must have execution arrangements that enable the Licence Holder to comply with its obligations under SLCs 2.63 to 2.69 when it places or transmits orders to that entity for execution.

The Licence Holder shall provide appropriate information to its clients on the policy established in accordance with this SLC.

2.68 The Licence Holder shall monitor on a regular basis the effectiveness of the policy established in accordance with SLC 2.67 and, in particular, the execution quality of the entities identified in that policy and, where appropriate, correct any deficiencies

In addition, the Licence Holder shall review the policy annually. Such a review shall also be carried out whenever a material change occurs that affects the Licence Holder's ability to continue to obtain the best possible result for its clients.

2.69 SLCs 2.63 to 2.68 shall not apply when the Licence Holder that provides the service of portfolio management and/or reception and transmission of orders also executes the orders received or the decisions to deal on behalf of its client's portfolio. In those cases, SLCs 2.54 to 2.58 shall apply.

Execution Policy

2.70 The Licence Holder shall review annually the execution policy established pursuant to SLC 2.55 as well as its order execution arrangements.

Such a review shall also be carried out whenever a material change occurs that affects the Licence Holder's ability to continue to obtain the best possible result of the execution of its clients orders on a consistent basis using the venues included in its execution policy.

2.71 The Licence Holder shall provide Retail Clients with the following details on their execution policy in good time prior to the provision of the service:

a. an account of the relative importance the Licence Holder assigns, in accordance with the criteria specified in SLC 2.59, to the factors referred to in SLC 2.54, or the process by which the Licence Holder determines the relative importance of those factors;

b. a list of the execution venues on which the Licence Holder places significant reliance in meeting its obligation to take all reasonable steps to obtain on a consistent basis the best possible result for the execution of client orders;

c. a clear and prominent warning that any specific instructions from a client may prevent the Licence Holder from taking the steps that it has designed and implemented in its execution policy to obtain the best possible result for the execution of those orders in respect of the elements covered by those instructions;

This information shall be provided in a durable medium, or by means of a website (where that does not constitute a durable medium) provided that the conditions specified in SLC 2.115 are satisfied.

Client Order Handling Rules

General

2.72 The Licence Holder which is licensed to execute orders on behalf of clients (deal as agent) shall implement procedures and arrangements which provide for the prompt, fair and expeditious execution of client orders, relative to other client orders or the trading interests of the Licence Holder . These procedures or arrangements shall

allow for the execution of otherwise comparable client orders in accordance with the time of their reception by the Licence Holder.

2.73 In the case of a client limit order in respect of shares admitted to trading on a regulated market which are not immediately executed under prevailing market conditions, the Licence Holder is, unless the client expressly instructs otherwise, to take measures to facilitate the earliest possible execution of that order by making public immediately that client limit order in a manner which is easily accessible to other market participants.

The Licence Holder is deemed to comply with this requirement by transmitting the client limit order to a regulated market and/or MTF. MFSA may waive the obligation to make public a limit order that is large in scale compared with normal market size as determined in terms of the Financial Markets Act (Transparency) Regulations, 2007.

2.74 When carrying out client orders, the Licence Holder shall satisfy the following conditions:

a. it must ensure that orders executed on behalf of clients are promptly and accurately recorded and allocated;

b. it must carry out otherwise comparable client orders sequentially and promptly unless the characteristics of the order or prevailing market conditions make it impracticable, or the interests of the client require otherwise;

c. it must inform a Retail Client about any material difficulty relevant to the proper carrying out of orders promptly upon becoming aware of the difficulty.

2.75 Where a Licence Holder is responsible for overseeing or arranging the settlement of an executed order, it shall take all reasonable steps to ensure that any client Instruments or client money received in settlement of that executed order are promptly and correctly delivered to the account of the appropriate client.

2.76 A Licence Holder shall not misuse information relating to pending client orders, and shall take all reasonable steps to prevent the misuse of such information by any of its relevant persons.

Aggregation and allocation of orders.

2.77 A Licence Holder shall not carry out a client order or a transaction for own account in aggregation with another client order unless the following conditions are met:

a. it must be unlikely that the aggregation of orders and transactions will work overall to the disadvantage of a client whose order is to be aggregated;

b. it must be disclosed to each client whose order is to be aggregated that the effect of aggregation may work to its disadvantage in relation to a particular order;

c. an order allocation policy must be established and effectively implemented, provided in sufficiently precise terms for the fair allocation of aggregated orders and transactions, including how the volume and price of orders determines allocations and the treatment of partial executions.

2.78 Where a Licence Holder aggregates an order with one or more other client orders and the aggregated order is partially executed, it is expected to allocate the related trades in accordance with its order allocation policy.

Aggregation and allocation of transactions for own account.

2.79 The Licence Holder which aggregates transactions for own account and with one or more client orders shall not allocate the related trades in a way that is detrimental to a client.

2.80 Where a Licence Holder aggregates a client order with a transaction for own account and the aggregated order is partially executed, the Licence Holder is expected to allocate the related trades to the client in priority to itself.

However, if the Licence Holder is able to demonstrate on reasonable grounds that without the combination it would not have been able to carry out the order on such advantageous terms, or at all, it may allocate the transaction for own account proportionally, in accordance with its order allocation policy referred to in SLC 2.77(c).

2.81 The Licence Holder shall, as part of the order allocation policy referred to in SLC 2.77(c), put in place procedures designed to prevent the reallocation, in a way that is detrimental to the client, of transactions for own account which are executed in combination with client orders.

Transactions Executed with Eligible Counterparties

2.82 A Licence Holder authorised to execute orders on behalf of clients and/or deal on its own account and/or to receive and transmit orders, may bring about or enter into transactions with Eligible Counterparties without being obliged to comply with the obligations under these Rules which fall under the following sub-sections of the Conduct of Business Obligations: 'General', 'Client Profile Requirements', 'Client Disclosure Requirements', 'Client Reporting', 'Best Execution Requirements' and SLC 2.72 in respect of 'Client Order Handling' – in respect to those transactions or in respect of any Ancillary Service directly related to those transactions.

Record Keeping

2.83 The Licence Holder shall arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable MFSA to monitor compliance with the requirements under these Rules, and in particular to ascertain that the Licence Holder has complied with all obligations with respect to clients or potential clients. In this regard, MFSA reserves the right to require a Licence Holder to record telephone conversations and/or electronic communications involving client orders.

In complying with this SLC, the Licence Holder shall refer to Articles 7 and 8 of the Commission Regulation.

Moreover, the Licence Holder shall also keep at the disposal of the MFSA, for at least five years, the relevant data relating to all transactions in Instruments which it has carried out, whether on own account or on behalf of a client. In the case of transactions carried out on behalf of clients, the records shall contain all the information and details of the identity of the client, and the information required under the Prevention of Money Laundering Act, 1994 and Regulations issued thereunder.

A summary of the records which the Licence Holder is expected to retain for the purposes of this SLC are found in Appendix 7 to these Rules.

2.84 The Licence Holder shall retain all the records required under these Rules and the Commission Regulation for a period of at least 5 years.

Additionally records which set out the respective rights and obligations of the Licence Holder and the client under an agreement to provide services, or the terms on which the Licence Holder provides services to the client, shall be retained for at least the duration of the relationship with the client.

However, MFSA, may, in exceptional circumstances, require the Licence Holder to retain any or all of those records for such longer period as is justified by the nature of the Instrument or transaction, if that is necessary to enable MFSA to exercise its supervisory functions.

2.85 The records shall be retained in a medium that allows the storage of information in a way accessible for future reference by the MFSA and in such a form and manner that the following conditions are met:

a. MFSA must be able to access them readily and to reconstitute each key stage of the processing of each transaction;

b. it must be possible for any corrections or other amendments, and he contents of the records prior to such corrections or amendments, to be easily ascertained;

c. it must not be possible for the records otherwise to be manipulated or altered.

Safeguarding of Client Assets

Note: ***the*** *Licence Holder holding or controlling Client Assets shall be required to comply with the SLCs in this Section in addition to the relevant provisions of the Investment Services Act (Control of Assets) Regulations, 1998 as amended.*

For the purposes of these Rules, the term "Client Assets" shall mean Instruments and money belonging to the client.

General

2.86 For the purposes of safeguarding client's rights in relation to Instruments and money belonging to them which are held or controlled by the Licence Holder, the latter shall comply with the following requirements:

a. they must keep such records and accounts as are necessary to enable them at any time and without delay to distinguish assets held for one client from assets held for another client, and from their own assets;

b. they must maintain their records and accounts in a way that ensures their accuracy, and in particular their correspondence to the Instruments and money held for clients;

c. they must conduct, on a regular basis, reconciliations between their internal accounts and records and those of any third parties by whom those assets are held;

d. they must take the necessary steps to ensure that any client Instruments deposited with a third party, in accordance with SLCs 2.87 to2.89 are identifiable from the Instruments belonging to the Licence Holder and from the Instruments belonging to that third party, by means of differently titled accounts on the books of the third party or other equivalent measures that achieve the same level of protection;

e. they must take the necessary steps to ensure that the client money deposited in accordance with SLC 2.90 to 2.91 with a central bank, an EEA credit institution or a bank authorized in a third country or a qualifying money market fund, are held in an account or accounts identified separately from any accounts used to hold money belonging to the Licence Holder;

f. they must introduce adequate organisational arrangements to minimise the risk of the loss or diminution of client assets, or of rights in connection with those assets, as a result of misuse of the assets, fraud, poor administration, inadequate record-keeping or negligence.

Depositing Client Instruments

2.87 A Licence Holder is permitted to deposit Instruments held by it on behalf of its clients into an account or accounts opened with a third party provided that the Licence Holder exercises all due skill, care and diligence in the selection, appointment and periodic review of the third party and of the arrangements for the holding and safekeeping of those Instruments.

In particular, the Licence Holder, shall take into account the expertise and market reputation of the third party as well as any legal requirements or market practices related to the holding of those Instruments that could adversely affect clients' rights.

2.88 If the safekeeping of Instruments for the account of another person is subject to specific regulation and supervision in a jurisdiction where a Licence Holder proposes to deposit client Instruments with a third party, the Licence Holder shall not deposit those Instruments in that jurisdiction with a third party which is not subject to such regulation and supervision.

2.89 The Licence Holder shall not deposit Instruments held on behalf of clients with a third party in a third country that does not regulate the holding and safekeeping of Instruments for the account of another person unless one of the following conditions are met:

a. the nature of the Instruments or of the Investment Services connected with those Instruments requires them to be deposited with a third party in that third country;

b. where the Instruments are held on behalf of a Professional Client, that client requests the Licence Holder to deposit them with a third party in that third country.

Depositing Client Money

2.90 Licence Holder, on receiving any client money, shall promptly place that money into one or more accounts opened with any of the following:

a. a central bank;

b. a credit institution authorised in accordance with Directive 2006/48/EC;

c. a bank authorised in a third country;

d. a qualifying money market fund.

Point (a) above shall not apply to a credit institution authorised under Directive 2006/48/EC in relation to deposits within the meaning of that Directive held by that institution.

2.91 Where the Licence Holder does not deposit client money with a central bank, it shall exercise all due skill, care and diligence in the selection, appointment and periodic review of the credit institution, bank or money market fund where the money is placed and of the arrangements for the holding of that money.

In particular, the Licence Holder shall take into account the expertise and market reputation of such institutions or money market funds with a view to ensuring the protection of clients' rights as well as any legal or regulatory requirements or market practices related to the holding of client money that could adversely affect client's rights.

Clients shall have the right to oppose the placement of their money in a qualifying money market fund.

Use of Clients' Instruments

2.92 A Licence Holder shall not enter into arrangements for securities financing transactions in respect of Instruments which it holds on behalf of a client, or otherwise use such Instruments for its own account or the account of another client of the Licence Holder, unless the following conditions are met:

a. the client must have given his prior express consent to the use of the Instruments on specified terms, as evidenced, in the case of a Retail Client, by his signature or equivalent alternative mechanism;

b. the use of that client's Instrument must be restricted to the specific terms to which the client consents.

2.93 The Licence Holder shall not enter into arrangements for securities financing transactions in respect of Instruments which are held on behalf of a client in a Nominee account maintained by a third party, or otherwise use Instruments held in such an account for their own account or for the account of another client unless, in addition to the conditions set out in SLC 2.92, at least one of the following conditions are met:

a. each client whose Instruments are held together in a Nominee account must have given prior express consent in accordance with point (a) of SLC 2.92;

b. the Licence Holder must have in place systems and controls which ensure that only Instruments belonging to clients who have given prior express consent in accordance with point (a) of SLC 2.92 are so used.

The records of the Licence Holder shall include details of the client on whose instructions the use of the Instruments has been effected, as well as the number of Instruments used belonging to each client who has given his consent, so as to enable the correct allocation of any loss.

Conflicts of Interest

General

2.94 The Licence Holder shall maintain and operate effective organisational and administrative arrangements with a view to taking all reasonable steps designed to prevent conflicts of interest as defined in this Section from adversely affecting the interests of its clients.

2.95 The Licence Holder shall take all steps to identify conflicts of interests between themselves, including their managers, employees or any person directly or indirectly linked to them by control and their clients or between one client and another that arise in the course of providing any investment and Ancillary Services, or combinations thereof.

2.96 Where the organisational or administrative arrangements made by the Licence Holder in accordance with SLC 2.94 to manage conflicts of interest are not sufficient to ensure, with reasonable confidence, that risks of damage to client interests will be prevented, the Licence Holder shall clearly disclose the nature and/or sources of conflicts of interest to the client before undertaking business on its behalf.

Such disclosure shall be made in a durable medium and shall include sufficient detail, taking into account the nature of the client, to enable that client to take an informed decision with respect to the Investment or Ancillary Service in the context of which the conflict of interest arises.

2.97 For the purposes of identifying the types of conflict of interest that arise in the course of providing investment and Ancillary Services or a combination thereof and whose existence may damage the interests of a client, the Licence Holder shall take into account, by way of minimum criteria, the question of whether itself or a relevant person, or a person directly or indirectly linked by control to the Licence Holder, is in any of the following situations, whether as a result of providing Investment or Ancillary Services or investment activities or otherwise:

a. the Licence Holder or that person is likely to make a financial gain, or avoid a

financial loss at the expense of the client;

b. the Licence Holder or that person has an interest in the outcome of a service provided to the client or of a transaction carried out on behalf of the client, which is distinct from the client's interest in that outcome;

c. the Licence Holder or that person has a financial or other incentive to favour the interests of another client or group of clients over the interests of the client;

d. the Licence Holder or that person carries on the same business as the client;

e. the Licence Holder or that person receives or will receive from a person other than the client, an inducement in relation to a service provided to the client, in the form of monies, goods or services, other than the standard commission or fee for that service.

Conflicts of Interest Policy.

2.98 The Licence Holder shall establish, implement and maintain an effective conflicts of interest policy set out in writing and appropriate to the size and organisation of the Licence Holder and the nature, scale and complexity of its business.

Where the Licence Holder is a member of a group, the policy must also take into account any circumstances, of which the Licence Holder is or should be aware, which may give rise to a conflict of interest arising as a result of the structure and business activities of other members of the group.

2.99 The conflicts of interest policy established in accordance with SLC 2.98, shall include the following content:

a. it must identify, with reference to the specific Investment Services and activities and Ancillary Services carried out by or on behalf of the Licence Holder, the circumstances which constituted or may give rise to a conflict of interest entailing a material risk of damage to the interests of one or more clients;

b. it must specify procedures to be followed and measures to be adopted in order to manage such conflicts.

2.100 The procedures and measures provided for in SLC 2.99(b) are to be designed to ensure that relevant persons engaged in different business activities involving a conflict of interest of the kind specified in SLC 2.99(a), carry on those activities at a level of independence appropriate to the size and activities of the Licence Holder and of the group to which it belongs, and to the materiality of the risk of damage to the interests of clients.

For the purposes of SLC 2.99(b), the procedures to be followed and measures to be adopted shall include such of the following as are necessary and appropriate for the Licence Holder to ensure the requisite degree of independence:

a. effective procedures to prevent or control the exchange of information between relevant persons engaged in activities involving a risk of a conflict of interest where the exchange of that information may harm the interests of one or more clients;

b. the separate supervision of relevant persons whose principal functions involve carrying out activities on behalf of, or providing services to, clients whose interests may conflict, or who otherwise represent different interests that may conflict, including those of the Licence Holder;

c. the removal of any direct link between the remuneration of relevant persons principally engaged in one activity and the remuneration of, or revenues generated by, different relevant persons principally engaged in another activity, where a conflict of interest may arise in relation to those activities;

d. measures to prevent or limit any person from exercising inappropriate influence over the way in which a relevant person carries out Investment or Ancillary Services or activities;

e. measures to prevent or control the simultaneous or sequential involvement of a relevant person in separate Investment or Ancillary Services or activities where such involvement may impair the proper management of conflicts of interests.

If the adoption or the practice of one or more of those measures and procedures does not ensure the requisite degree of independence, the Licence Holder shall adopt such alternative or additional measures and procedures as are necessary and appropriate for those purposes.

Record Keeping

2.101 A Licence Holder shall keep and regularly update a record of the kinds of Investment or Ancillary Service or investment activity carried out by or on behalf of the Licence Holder in which a conflict of interest entailing a material risk of damage to the interests of one or more clients has arisen or, in the case of an ongoing service or activity, may arise.

Staff Dealing

General

2.102 A Licence Holder shall establish adequate policies and procedures sufficient to ensure compliance of the Licence Holder, including its managers and employees, with its obligations under these Rules as well as appropriate rules governing personal transactions by such persons.

Personal Transactions

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

a. entering into a transaction which meets at least one of the following criteria:

i. that person is prohibited from entering into it under the Prevention of Financial Markets Abuse Act, 2005;

ii. it involves the misuse of improper disclosure of that confidential information;

iii. it conflicts or is likely to conflict with an obligation of the Licence Holder under these Rules.

b. advising or procuring, other than in the proper course of his employment or contract for services, any other person to enter into a transaction in Instruments which, if a personal transaction of the relevant person, would be covered by point (a) above or by SLC 2.112 (a) or (b) or SLC 2.76.

c. Without prejudice to Article 6(2) of the Prevention of Financial Markets Abuse Act, 2005, disclosing, other than in the normal course of his employment or contract for services, any information or opinion to any other person if the relevant person knows, or reasonably ought to know, that as a result of that disclosure, that other person will or would be likely to take either of the following steps:

i. to enter into a transaction in Instruments which, if a personal transaction of the relevant person, would be covered by point (a) above or SLC 2.112 (a) or (b) or SLC 2.76;

ii. to advise or procure another person to enter into such a transaction.

2.104 The arrangements required under SLC 2.103 must be designed in particular to ensure that:

a. each relevant person covered by SLC 2.103 is aware of the restrictions on personal transactions, and of the measures established by the Licence Holder in connection with personal transactions and disclosure, in accordance with SLC 2.103;

b. the Licence Holder is informed promptly of any personal transaction entered into by a relevant person, either by notification of that transaction or by other procedures enabling the Licence Holder to identify such transactions;

In the case of outsourcing arrangements, the Licence Holder must ensure that the Licence Holder to which the activity is outsourced, maintains a record of personal transactions entered into by any relevant person and provides that information to the Licence Holder promptly on request;

c. a record is kept of the personal transaction notified to the Licence Holder or identified by it, including any authorisation or prohibition in connection with such a transaction.

2.105 SLC 2.103 and SLC 2.104 shall not apply to the following kinds of personal transactions:

a. personal transactions effected under a discretionary portfolio management service where there is no prior communication in connection with the transaction between the portfolio manager and the relevant person or other person for whose account the transaction is executed;

b. personal transactions in units in collective undertakings that comply with the conditions necessary to enjoy the rights conferred by the UCITS Directive or are subject to supervision under the law of a Member State which requires an equivalent level of risk spreading in their assets, where the relevant person and any other person for whose account the transactions are effected, are not involved in the management of that undertaking.

Provision of services though the medium of another Licence Holder

2.106 A Licence Holder receiving an instruction to perform Investment or Ancillary Services on behalf of a client through the medium of another investment firm, shall be able to rely on client information transmitted by the latter. The investment firm which mediates the instructions will remain responsible for the completeness and

accuracy of the information transmitted.

2.107 The Licence Holder which receives an instruction to undertake services on behalf of a client through the medium of another investment firm, shall also be able to rely on any recommendations in respect of the service or transaction that have been provided to the client by another investment firm. The investment firm which mediates the instructions will remain responsible for the appropriateness for the client of the recommendations or advice provided.

2.108 The Licence Holder which receives client instructions or orders through the medium of another Licence Holder, shall remain responsible for concluding the service or transaction, based on any such information or recommendations, in accordance with the relevant provisions of these Rules[2].

Conduct of Business Rules for a Licence Holder Producing and Disseminating Investment Research

2.109 For the purposes of this Section, "investment research" means research or other information recommending or suggesting an investment strategy, explicitly or implicitly, concerning one or several Instruments or the issuers of 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;

b. if the recommendation in question were made by a Licence Holder to a client, it would not constitute the provision of investment advice for the purposes of the Act.

2.110 A recommendation of the type covered by Regulation 2(1) of the Prevention of Financial Markets Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations, 2005 (Legal Notice 106 of 2005), but relating to Instruments as defined in the Act, that does not meet the conditions set out in SLC2.109, shall be treated as a marketing communication for the purposes of these Rules, and any Licence Holder which produces or disseminates the recommendation shall ensure that it is clearly identified as such

Additionally, the Licence Holder shall ensure that any such recommendation contains a clear and prominent statement that (or, in the case of an oral recommendation to the effect that) it has not been prepared in accordance with legal

[2] Inserted on 16th November, 2007

requirements designed to promote the independence of investment research and that it is not subject to any prohibition on dealing ahead of the dissemination of investment research

2.111 A Licence Holder which produces, or arranges for the production of investment research that is intended or likely to be subsequently disseminated to clients of the Licence Holder or to the public, under its own responsibility or that of a member in its group (if the Licence Holder is a member of a group), shall ensure that the implementation of all the measures set out in SLC 2.100 in relation to the financial analysts involved in the production of the investment research and other relevant persons whose responsibilities or business interests may conflict with the interests of the persons to whom the investment research is disseminated.

2.112 The Licence Holder which is covered under SLC 2.111 shall have in place arrangements designed to ensure that the following conditions are satisfied:

a. financial analysts and other relevant persons must not undertake personal transactions or trade other than as market makers acting in good faith and in the ordinary course of market making or in the execution of an unsolicited client order, on behalf of any other person, including the Licence Holder, in Instruments to which investment research relates, or in any related Instruments, with knowledge of the likely timing or content of that investment research which is not publicly available or available to clients and cannot readily be inferred from information that is so available, until the recipients of the investment research have had a reasonable opportunity to act on it;

b. in circumstances not covered by point (a), financial analysts and any other relevant persons involved in the production of investment research must not undertake personal transactions in Instruments to which the investment research relates, or in any related Instruments, contrary to current recommendations, except in exceptional circumstances and with the prior approval of a member of the Licence Holder's legal or compliance function;

c. the Licence Holder itself, financial analysts and other relevant persons involved in the production of investment research must not accept inducements from those with a material interest in the subject matter of the investment research;

d. the Licence Holder itself, financial analysts, and other relevant persons involved in the production of the investment research must not promise issuers favourable research coverage;

e. issuers, relevant persons other than financial analysts, and any other persons must not before the dissemination of investment research be permitted to review a draft of the investment research for the purpose of verifying the

accuracy of factual statements made in that research, or for any other purpose other than verifying compliance with the Licence Holder's legal obligations, if the draft includes a recommendation or a target price.

For the purposes of this SLC, "related Instrument" means an Instrument the price of which is closely affected by price movements in another Instrument which is the subject of investment research, and includes a derivative on that other Instrument.

2.113 The Licence Holder which disseminates investment research produced by another person to the public or to clients shall be exempted from complying with the requirements of SLC 2.112 if the following criteria are met:

a. the person that produces the investment research is not a member of the group to which the Licence Holder belongs;

b. the Licence Holder does not substantially alter the recommendations within the investment research;

c. the Licence Holder does not present the investment research as having been produced by it;

d. the Licence Holder verifies that the producer of the research is subject to requirements equivalent to the requirements under these Rules in relation to the production of that research, or has established a policy setting such requirements.

Conditions Applicable to the Provision of Information

2.114 Where, for the purposes of these Rules, information is required to be provided in a durable medium, the Licence Holder may provide that information in a durable medium other than on paper only if:

a. the provision of that information in that medium is appropriate to the context in which the business between the Licence Holder and the client is, or is to be, carried on; and

b. the person to whom the information is to be provided, when offered the choice between information on paper or in that other durable medium, specifically chooses the provision of the information in that other medium.

2.115 Where the Licence Holder provides the information it is bound to provide in terms of these Rules to a client, by means of a website and that information is not addressed personally to the client, the following conditions shall be satisfied:

a. the provision of that information in that medium is appropriate to the context in

which the business between the Licence Holder and the client is, or is to be, carried on;

b. the client must specifically consent to the provision of that information in that form;

c. the client must be notified electronically of the address of the website, and the place on the website where the information may be accessed;

d. the information must be up to date;

e. the information must be accessible continuously by means of that website for such period of time that the client may reasonably need to inspect it.

2.116 For the purposes of SLCs 2.114 and 2.115, the provision of information by means of electronic communications shall be treated as appropriate to the context in which the business between the Licence Holder and the client is, or is to be, carried on if there is evidence that the client has regular access to the internet. The provision by the client of an email address for the purposes of the carrying on of that business shall be treated as such evidence.

Complaints Handling

2.117 The Licence Holder is required to establish, implement and maintain effective and transparent procedures for the reasonable and prompt handling of complaints received from Retail Clients or potential Retail Clients, and to keep a record of each complaint and the measures taken for its resolution. The Licence Holder is also required to inform complainants that they may refer their complaint to the MFSA if they are not satisfied with the manner in which it has been handled by the Licence Holder.

Provisions Applicable to a Licence Holder whose Staff promote and Sell Investment Products

Note: *For the purposes of the following SLCs, reference to 'promote and sell' should be interpreted as the practice whereby the Licence Holder's staff explain the features of a particular product to a client or prospective client without actually providing investment advice with respect to that product, such that it is the client who ultimately decides for himself/herself whether to invest in the particular product or not.*

2.118 The Licence Holder may allow its staff to promote and sell investment products subject to:

a. appropriate internal controls and internal compliance checks being in place to ensure that:

   i. no investment recommendations are made or investment advice is provided by staff members who are not authorized to provide advice in terms of SLC 1.07(i);

   ii. the relevant Rules on disclosure to clients particularly SLC 2.27, 2.28, 2.37, 3.10 to 3.14 and 3.22 and SLC 2.119 below are observed by staff members promoting and selling investment products provided that for the purposes of SLC 3.10, all clients may be treated as retail and staff need not carry out a client classification exercise in terms of SLC 2.03 prior to explaining the features of an investment product. Such client classification exercise should be made once a client decides to submit an order for execution with respect to the investment product being promoted.

   iii. an appropriateness test as per SLC 2.14 is carried out by staff members before receiving and transmitting any orders for investment in the products concerned unless all the conditions indicated in SLC 2.25 are met

b. staff being required to follow documented procedures which should be drawn up by theLicence Holder to ensure that its staff promoting and selling investment products are aware of the relevant procedures, including regulatory requirements they are to follow when promoting and selling investment products.

2.119 Staff involved in the promotion and sale of investment products must also clearly disclose to clients:

a. that they are only in a position to offer information on one or a limited range of investment products; that the information provided does not constitute investment advice and that should clients require advice, they will be referred to an authorized advisor. Except for non face to face communications with clients, this disclosure should be provided in writing and be countersigned by the client;

b. any connections which the Licence Holder may have with the product provider; and

c. the nature of the Licence Holder's interest in promoting and selling the particular products, taking account of the relevant requirements of SLC 2.02.

2.120 The Licence Holder must, at all times, maintain adequate records pertaining to staff

who are not authorized advisors but who provide information to clients and who promote and sell investment products. Such records should include:

a. an up-dated list of the names of staff members who are authorized by the Licence Holder to promote and sell investment products, together with details of the training provided to such persons as per SLC 2.122 below;

b. evidence of internal compliance checks undertaken by the Licence Holder and

c. details of any disciplinary action taken against staff involved in the selling and promoting of investment products.

2.121 The records referred to in SLC 2.120 above should be available for inspection by MFSA officials during Compliance Visits.

2.122 The details of training provided to the Licence Holder's staff which the Licence Holder must retain in terms of SLC 2.120 (a) include:

a. a description of the training provided, including details of the course content;

b. details of the identity and experience of the trainer/s; and

c. a declaration that the trainer is satisfied that the persons who attended the training have achieved a standard of competence that indicates that they are capable of clearly explaining the features of the product in question.

Provisions Applicable to a Licence Holder Appointing Tied Agents

Note: *For the purposes of these Rules reference to tied agents shall also include persons employed by a legal person which is registered as a tied agent of a Licence Holder, in terms the Investment Services (Tied Agents) Regulations, 2007 (hereinafter referred to as "the Regulations") and which are directly involved in carrying out tied agency activities.*

These Rules are additional and without prejudice to the obligations of the Licence Holder set out in the Regulations.

2.123 A Licence Holder may appoint a tied agent which is:

a. established in Malta , provided that such tied agent is registered by the MFSA or

b. established in an EU or EEA Member State provided that such tied agent is either:

i. registered as a tied agent in such EU or EEA Member State or

ii. registered in Malta if the EU or EEA Member State in which such tied agent is established does not provide for the registration of tied agents within its jurisdiction.

2.124 The responsibility for the control and monitoring of the activities of tied agents rests with the senior management of the Licence Holder. In this regard, the Licence Holder shall ensure that the tied agents it appoints:

a. report to it on a regular basis with respect to the activities carried out by the tied agent;

b. pass on to the Licence Holder all the necessary documentation for processing and/or record keeping purposes, promptly;

c. continue to satisfy the registration requirements and the eligibility criteria referred in Part A of these Rules on an on-going basis;

d. do not hold or control clients' money or assets;

e. comply with the requirements of the Investment Services Rules which are relevant to the activities they carry out on behalf of the Licence Holder. Particular attention should be given by the Licence Holder to ensuring compliance, by the tied agent, with the relevant requirements in this Section entitled "Conduct of Business Obligations" and in Section 3 entitled "Disclosure Requirements for Information to Clients, including Marketing Communications".

2.125 The Licence Holder shall ensure that the tied agents it appoints, shall, where appropriate make a prior appointment to call clients or potential clients. Unsolicited or unarranged calls shall be made between 9.00 a.m., and 7.00 p.m. Monday to Friday (excluding public holidays and Saturday) from 9.00a.m. to 5.00 p.m., unless otherwise requested by an existing or potential client.

2.126 The Licence Holder shall look into any concerns that may arise at any time regarding its tied agents' fit and proper status and take the necessary action. The necessary action may include, for example, increased monitoring or, if appropriate, suspension or termination of the appointment. In all cases, the Licence Holder should report any concerns it may have in this regard, to the MFSA, without delay.

2.127 The Licence Holder shall take reasonable steps to ensure that each of its tied agents:

a. carry on only those activities which are permissible in terms of the definition of "tied agent" in regulation 2 of the Regulations and provided such activities are in line with the terms of the terms of the tied agent's appointment by the Licence Holder.

b. carries on the activity for which the Licence Holder has accepted responsibility in a way which is, and is held out as being, clearly distinct from any of the tied agent's other business, irrespective of whether such other business is regulated or not.

2.128 The Licence Holder will be held responsible for any breaches of the Rules committed by any of the tied agents it appoints.

2.129 When carrying out tied agent activities from a place of business or from any other place accessible to the public, the Licence Holder shall require the tied agent to display in a prominent position in that place, or in a part thereof to which the public has access, the certificate of registration or an official copy thereof issued by the Authority.

2.130 The Licence Holder shall maintain all records, including those relating to the "Know Your Client" procedures and evidence that the tied agent has carried out the necessary suitability and/or appropriateness tests in terms of SLCs 2.23 to 2.26, pertaining to the activities performed by the tied agents on the Licence Holder's behalf, as are necessary to demonstrate compliance by the tied agent with the relevant provision of these Rules. Such records shall be made available to MFSA officials during Compliance Visits.

2.131 The Licence Holder shall ensure that its tied agents:

a. do not act as such for other Licence Holders and

b. are not involved in any activities which may give rise to a conflict of interest which could be detrimental to the Licence Holder's clients

2.132 The Licence Holder is to inform the MFSA of any decision to terminate a tied agent's appointment and shall confirm whether such a decision was taken due to any issues of a regulatory nature or concern.

Provisions Applicable to a Licence Holder Appointing Introducers

2.133 The MFSA is to be advised by the Licence Holder of the names and addresses of the

Introducers.

2.134 The Licence Holder is responsible for "Know Your Customer" checks and cannot rely on the Introducer's opinion.

2.135 The Introducer is bound by confidentiality as to the means and resources of the customer if s(he) is made aware of them.

2.136 In no circumstances can the Introducer give investment advice, promote a certain product or undertake any Investment Services licensable activity.

2.137 The Introducer will not be permitted to pass on any documentation, promoting any particular product or service on behalf of the Licence Holder, to the client/ or to assist the client in the completion of any relevant documentation.

2.138 The Introducer will not be permitted to receive any funds from clients or give any commitments on behalf of the Licence Holder.

2.139 The Introducer's involvement will be limited to arranging a meeting between the Licence Holder and the customer, but can also attend the meeting if required.

2.140 The Introducer should not hold himself out to the general public as acting as Introducer and should not actively promote its "introducing services".

2.141 Charges which the client/ investor will incur should not differ irrespective of whether the client approached the Licence Holder direct or through an Introducer.

2.142 Insurance companies authorised under the Insurance Business Act, 1998 ("the IBA") and insurance agents and insurance brokers enrolled under the Insurance Intermediaries Act, 2006 ("the IIA") cannot act as Introducers. In accordance with article 8(b) of the IBA, the objects of insurance companies are to be limited to business of insurance, as defined in the said Act. In the case of enrolled agents and brokers, in terms of article 10(1)(a)(i) of the IIA the business of such persons is to be limited to insurance intermediaries activities as defined in the said Act. Insurance agents and insurance brokers enrolled under the IIA are permitted in accordance with Insurance Intermediaries Rule 11 of 2007, to carry on Investment Services activities provided that the insurance intermediaries concerned are granted an Investment Services licence under the Investment Services Act, 1994.

2.143 Insurance sub-agents are permitted to act as Introducers for authorised companies in whose Sub-agents Company Register they are registered and on whose behalf they are enrolled in terms of the IIA or for wholly-owned Investment Services subsidiaries of such authorised companies.

2.144 A record is to be retained, for inspection by the MFSA's Compliance Officers, of

commissions paid to each introducer.

2.145 Introducers may only act as such for one Licence Holder.

3. Disclosure Requirements for Information to Clients, including Marketing Communications

General

3.01 All information, including marketing communications addressed by the Licence Holder to clients or potential clients shall be fair, clear and not misleading by complying with the conditions set out below. Marketing communications (which include 'investment advertisements' as defined in Article 2(1) of the Act) shall:

i. be clearly identifiable as such.

ii. be considered to be fair, clear and not misleading if they comply with the conditions set out in SLC 3.02 - 3.09.

For the avoidance of doubt the following are not subject to the rules contained in SLCs 3.02 – 3.23 but are still subject to the requirements of this SLC, requiring them to be "fair clear and not misleading":

a. marketing communications which falls within the definition of "advertorial" as defined in the Glossary to these Rules; and

b. marketing communications which consist only of one or more of the following: the name of the Licence Holder, a logo or other image associated with the Licence Holder, a contact point, a reference to the types of Investment Services offered by the Licence Holder or to its fees and commissions.

3.01A The Licence Holder shall ensure that appropriate records of all issued and/or approved marketing communications are maintained and made available for inspection by the MFSA within 24 hours of its request, for not less than five years from the date of publication or broadcast. Such records should include:

a. the name of the individual who approved the communications;

b. the date of approval of the information;

c. the publication/s in which the marketing communication was included; and

d. evidence to support any statement made in the information and which is not a statement of fact.

Marketing Information and other Information for Retail Clients and Potential Retail Clients

3.02 The Licence Holder shall ensure that all information it addresses to, or disseminates in such a way that it is likely to be received by Retail Clients or potential Retail Clients, including marketing communications, satisfies the following conditions. It shall:

a. include the name of the Licence Holder;

b. be accurate, and in particular shall not emphasise any potential benefits of an Investment Service or Instrument without also giving a fair and prominent indication of any relevant risks;

c. be sufficient for, and presented in a way that is likely to be understood by, the average member of the group to whom it is directed, or by whom it is likely to be received;

d. not disguise, diminish or obscure important items, statements or warnings.

3.03 Where the information compares Investment or Ancillary Services, Instruments, or persons providing Investment or Ancillary Services, the following conditions shall be satisfied:

a. the comparison must be meaningful and presented in a fair and balanced way;

b. the sources of the information used for the comparison must be specified;

c. the key facts and assumptions used to make the comparison must be included.

3.04 Where the information contains an indication of past performance of an Instrument, a financial index or an Investment Service, the following conditions shall be satisfied:

a. that indication must not be the most prominent feature of the communication;

b. the information must include appropriate performance information which covers the immediately preceding 5 years, or the whole period for which the Instrument has been offered, the financial index has been established, or the Investment Service has been provided if less than 5 years, or such longer period as the Licence Holder may decide, and in

c. every case that performance information must be based on complete 12 month periods;

d. the reference period and the source of information must be clearly stated;

e. the information must contain a prominent warning that the figures refer to the past and that past performance is not a reliable indicator of future results;

f. where the indication relies on figures denominated in a currency other than that of the country in which the Retail Client or potential Retail Client is resident, the currency must be clearly stated, together with a warning that the return may increase or decrease as a result of currency fluctuations;

g. where the indication is based on gross performance, the effect of commissions, fees or other charges must be disclosed.

3.05 Where the information relates to future performance, the following conditions shall be satisfied:

a. the information must not be based on or refer to simulated past performance ;

b. it must be based on reasonable assumptions supported by objective dated;

c. where the indication is based on gross performance, the effect of commissions, fees or other charges must be disclosed;

d. it must contain a prominent warning that such forecasts are not a reliable indicator of future performance.

3.06 Where the information includes or refers to simulated past performance, it must relate to an Instrument or a financial index, and the following conditions shall be satisfied:

a. the simulated past performance must be based on the actual past performance of one or more Instruments or financial indices which are the same as, or underlie, the Instrument concerned;

b. in respect of the actual past performance referred in point (a), the conditions set out in points (a) to (c), (e) and (f) of SLC 3.04 must be complied with;

c. the information must contain a prominent warning that the figures refer to simulated past performance and that past performance is not a reliable indicator of future performance.

3.07 Where the information refers to a particular tax treatment, it shall prominently state that the tax treatment depends on the individual circumstances of each client may be subject to change in the future.

3.08 The information shall not use the name of the MFSA or other competent authority in

such a way that would indicate or suggest endorsement or approval by that authority of the products or services of the Licence Holder.

3.09 Where a marketing communication contains an offer or invitation of the following nature and specifies the manner of response or includes a form by which any response may be made, it shall include such of the information referred in SLCs 2.28 to 2.30 and SLC 3.10 to 3.22 as is relevant to the offer or invitation:

a. an offer to enter into an agreement in relation to an Instrument or Investment Service or Ancillary Service with any person who responds to the communication;

b. an invitation to any person who responds to the communication to make an offer to enter into an agreement in relation to an Instrument or Investment Service or Ancillary Service.

However, paragraph (a) shall not apply if, in order to respond to an offer or invitation contained in the marketing communication, the potential Retail Client must refer to another document or documents, which, alone or in combination, contain that information.

Information about Instruments.

3.10 The Licence Holder shall provide clients or potential clients with a general description of the nature and risks of Instruments, taking into account, in particular, the client's categorisation as either a Retail Client or a Professional Client. That description must explain the nature of the specific type of Instrument concerned, as well as the risks particular to that specific type of Instrument in sufficient detail to enable the client to take investment decisions on an informed basis.

3.11 The description of risks shall include, where relevant to the specific type of Instrument concerned and the status and level of knowledge of the client, the following elements:

a. the risks associated with that type of Instrument including an explanation of leverage and its effects and the risk of losing the entire investment;

b. the volatility of the price of such Instruments and any limitations on the available market for such Instruments;

c. the fact that an investor might assume as a result of transactions in such Instruments, financial commitments and other additional obligations, including contingent liabilities, additional to the cost of acquiring Instruments;

d. any margin requirements or similar obligations, applicable to Instruments of

that type.

3.12 If a Licence Holder provides a Retail Client or potential Retail Client with information about an Instrument that is the subject of a current offer to the public and a prospectus has been published in connection with that offer in accordance with Directive 2003/71/EC ("the Prospectus Directive"), that Licence Holder shall inform the client or potential client where that prospectus is made available to the public.

3.13 Where the risks associated with an Instrument composed of two or more different Instruments or services are likely to be greater than the risks associated with any of the components, the Licence Holder shall provide an adequate description of the components of that Instrument and the way in which its interaction increases the risks.

3.14 In the case of Instruments that incorporate a guarantee by a third party, the information about the guarantee shall include sufficient detail about the guarantor and the guarantee to enable the Retail Client or potential Retail Client to make a fair assessment of the guarantee.

Disclosure Requirements applicable to a Licence Holder holding or controlling Client Assets.

3.15 Where the Licence Holder holds or controls Instruments or money belonging to Retail Clients, the Licence Holder shall provide those Retail Clients or potential Retail Clients with the information specified in SLCs 3.16 to 3.21 as is relevant.

3.16 The Licence Holder shall inform the Retail Client or potential Retail Client where the Instrument or money of that client may be held by a third party on behalf of the Licence Holder and of the responsibility of the Licence Holder for any acts or omissions of the third party and the consequences for the client of the insolvency of the third party.

3.17 Where Instruments of the Retail Client or potential Retail Client may, be held in a Nominee account by a third party, the Licence Holder shall inform the client of this fact and shall provide a prominent warning of the resulting risks.

3.18 The Licence Holder shall inform the Retail Client or potential Retail Client where it is not possible for client Instruments held with a third party to be separately identifiable from the proprietary Instruments of that third party or of the Licence Holder and shall provide a prominent warning of the resulting risks.

3.19 The Licence Holder shall inform the client or potential client where accounts that contain Instruments or money belonging to that client or potential client are or will be subject to the law of a jurisdiction other than that of a Member State and shall indicate that the rights of the client or potential client relating to those Instruments or

money may differ accordingly.

3.20 A Licence Holder shall inform the client about the existence and the terms of any security interest or lien which the Licence Holder has or may have over the client's Instruments or money, or any right of set-off it holds in relation to those Instruments or money. Where applicable, it shall also inform the client of the fact that a depository may have a security interest or lien over, or right of set-off in relation to those Instruments or money.

3.21 A Licence Holder, before entering into securities financing transactions in relation to Instruments held by it on behalf of a Retail Client, or otherwise to use such Instruments for its own account or on the account of another client, shall in good time before the use of those Instruments provide the Retail Client, in a durable medium, with clear, full and accurate information on the obligations and responsibilities of the Licence Holder with respect to the use of those Instruments, including the terms for their restitution, and on the risks involved.

Information about Costs and Associated Charges.

3.22 The Licence Holder shall provide its Retail Clients with information on costs and associated charges that includes such of the following elements as are relevant:

a. the total price to be paid by the client in connection with the Instrument or the Investment Service or Ancillary Service, including all related fees, commission, charges and expenses, and all taxes applicable via the Licence Holder or, if an exact price cannot be indicated, the basis for the calculation of the total price so that the client can verify it. Commissions charged by the Licence Holder shall be itemised separately in every case;

b. where any part of the total price referred to in point (a) is to be paid in or represents an amount of foreign currency, an indication of the currency involved and the applicable currency conversion rates and costs;

c. notice of the possibility that other costs, including taxes, related to transactions in connection with the Instrument or the Investment Service may arise for the client that are not paid via the Licence Holder or imposed by it;

d. the arrangements for payment or other performance.

Information Drawn up in accordance with Directive 85/611/EEC (the UCITS Directive)

3.23 In respect of units in a collective investment scheme which qualifies as a UCITS under Directive 85/11/EEC, a simplified prospectus complying with Article 28 of that Directive is regarded as appropriate information for the purposes of:

a. the provision of information about Instruments and proposed investment strategies including appropriate guidance on and warnings of the risks associated with investments in those Instrument or in respect of particular investment strategies;

b. costs and associated charges related to the UCITS itself including the exit and entry commissions.

4. Outsourcing

General

4.01 A Licence Holder shall ensure, when relying on a third party for the performance of operational functions which are critical for the provision of continuous and satisfactory service to clients and the performance of investment activities on a continuous and satisfactory basis, that it takes reasonable steps to avoid undue additional operational risk. Outsourcing of important operational functions may not be undertaken in such a way as to impair materially the quality of its internal control and the ability of the MFSA to monitor the Licence Holder's compliance with all obligations.

4.02 An operational function of a Licence Holder shall be regarded as critical or important if a defect or failure in its performance would materially impair the continuing compliance of a Licence Holder with the conditions and obligations of its authorisation or its other obligations under these Rules, or its financial performance, or the soundness or the continuity of its Investment Services and activities.

4.03 Without prejudice to the status of any other function, the following functions shall not be considered as critical or important for the purposes of SLC 4.02:

a. the provision to the Licence Holder of advisory services, and other services which do not form part of the investment business of the Licence Holder, including the provision of legal advice to the Licence Holder, the training of the Licence Holder's personnel, billing services and the security of the Licence Holder's premises and personnel;

b. the purchase of standardised services, including market information services and the provision of price feeds.

Conditions for Outsourcing Critical or Important Operational Functions or Investment Services or Activities.

4.04 When the Licence Holder outsources critical or important operational functions or any Investment Services or activities, the Licence Holder remain fully responsible for discharging all of their obligations under these Rules and are required to comply, in particular with the following conditions:

a. the outsourcing must not result in the delegation by senior management of its responsibility;

b. the relationship and obligations of the Licence Holder towards its clients under these Rules must not be altered;

c. the compliance with the Licence Holder's applicable licence conditions must not be undermined;

d. none of the other conditions subject to which the Licence Holder was granted a licence must be removed or modified.

4.05 The Licence Holder shall exercise due skill, care and diligence when entering into, managing or terminating any arrangement for the outsourcing to a service provider of critical or important operational functions or of any Investment Services or activities.

The Licence Holder shall in particular take the necessary steps to ensure that the following conditions are satisfied:

a. the service provider must have the ability, capacity and any authorisation required by law to perform the outsourced functions, services or activities reliably and professionally;

b. the service provider must carry out the outsourced services effectively, and to this end the Licence Holder must establish methods for assessing the standard of performance of the service provider;

c. the service provider must properly supervise the carrying out of the outsourced functions, and adequately manage the risks associated with the outsourcing;

d. appropriate action must be taken if it appears that the service provider may not be carrying out the functions effectively and in compliance with applicable laws and regulatory requirements;

e. the Licence Holder must retain the necessary expertise to supervise the outsourced functions effectively and manage the risks associated with the outsourcing and must supervise those functions and manage those risks;

f. the service provider must disclose to the Licence Holder any development that may have a material impact on its ability to carry out the outsourced functions effectively and in compliance with applicable laws and regulatory requirements;

g. the Licence Holder must be able to terminate the arrangement for outsourcing where necessary without detriment to the continuity and quality of its provision of services to clients;

h. the service provider must cooperate with the MFSA in connection with the outsourced activities;

i. the Licence Holder, its auditors and the MFSA must have effective access to data related to the outsourced activities, as well as to the business premises of the service provider; and the MFSA must be able to exercise those rights of access;

j. the service provider must protect any confidential information relating to the Licence Holder and its clients;

k. the Licence Holder and the service provider must establish, implement and maintain a contingency plan for disaster recovery and periodic testing of backup facilities, where that is necessary having regard to the function, service or activity that has been outsourced.

4.06 The respective rights and obligations of the Licence Holder and of the service provider must be clearly allocated and set out in a written agreement.

4.07 Where the Licence Holder and the service provider are members of the same group, the Licence Holder may, for the purposes of complying with this Section, take into account the extent to which the Licence Holder controls the service provider or has the ability to influence its actions.

4.08 The Licence Holder shall make available to the MFSA, on request, all information necessary to enable the MFSA to supervise the compliance of the performance of the outsourced activities with the requirements of these Rules.

Service Providers Located in Third Countries.

4.09 In addition to the requirements of SLCs 4.04 to 4.08, where a Licence Holder outsources the Investment Service of portfolio management provided to Retail Clients to a service provider located in a third country, that Licence Holder shall ensure that the following conditions are satisfied:

a. the service provider must be authorised or registered in its home country to provide that service and must be subject to prudential supervision;

b. there must be an appropriate cooperation agreement between the MFSA and the supervisory authority of the service provider.

4.10 When one or both of the conditions referred to in SLC 4.09 are not satisfied, a Licence Holder may outsource Investment Services to a service provider located in a third country only if the Licence Holder gives prior notification to MFSA about the outsourcing arrangement and the MFSA does not object to that arrangement within a reasonable time following receipt of that notification.

4.11 The Licence Holder shall still be required to comply with the requirements of SLCs 4.04 to 4.08.

5. Supplementary Conditions for Operators of Multilateral Trading Systems

5.01 The operator of an MTF, shall establish transparent and non-discretionary rules and procedures for fair and orderly trading and shall establish objective criteria for the efficient execution of orders.

5.02 The operator of an MTF shall:

a. establish transparent rules regarding the criteria for determining the Instruments that can be traded under its systems; and

b. where applicable, provide or ensure that there is access to sufficient publicly available information to enable its users to form an investment judgement, taking into account both the nature of the users and the types of Instruments traded.

5.03 SLCs 2.02 to 2.81 are not applicable to the transactions concluded under the rules governing an MTF between its members or participants or between the MTF and its members or participants in relation to the use of the MTF. Provided that members of or participants in the MTF shall comply with the obligations provided for in the above-mentioned SLCs with respect to their clients when, acting on behalf of their clients, they execute their orders through the systems of an MTF.

5.04 The operator of an MTF shall establish and maintain transparent rules, based on objective criteria, governing access to its facility. These rules shall provide that the MTF may admit as members or participants Licence Holders, credit institutions authorised under Directive 2000/12/EC and other persons who:

a. are fit and proper;

b. have a sufficient level of trading ability and competence;

c. have, where applicable, adequate organisational arrangements; and

d. have sufficient resources for the role they are to perform, taking into account the different financial arrangements that the MTF may have established in order to guarantee the adequate settlement of transactions.

5.05 The operator of an MTF shall:

a. clearly inform its users of their respective responsibilities for the settlement of the transactions executed on that facility;

b. have in place the necessary arrangements to facilitate the efficient settlement of

the transactions concluded under the systems of the MTF.

5.06 Where a transferable security, which has been admitted to trading on a regulated market, is also traded on an MTF without the consent of the issuer, the MTF shall not make such issuers subject to any obligation relating to initial, ongoing or ad hoc financial disclosure.

5.07 The operator of an MTF shall comply immediately with any instruction from the MFSA to suspend or remove an Instrument from trading.

Compliance Arrangements

5.08 The operator of an MTF shall:

a. establish and maintain effective arrangements and procedures, relevant to the MTF, for the regular monitoring of the compliance by its users with its rules;

b. monitor the transactions undertaken by its users under their systems in order to identify breaches of its rules, disorderly trading conditions or conduct that may involve market abuse.

5.09 The operator of an MTF shall:

a. notify the MFSA of any significant breaches of its rules or disorderly trading conditions or conduct that may involve market abuse;

b. supply the relevant information without delay to the MFSA for the investigation and prosecution of market abuse and shall provide the MFSA with full assistance in investigating and prosecuting market abuse occurring on or through its systems.

Pre-trade transparency requirements for MTFs

5.10 The operator of an MTF shall make public current bid and offer prices and the depth of trading interests at those prices which are advertised through its systems in respect of shares admitted to trading on a regulated market. This information shall be made available to the public on reasonable commercial terms and on a continuous basis during normal trading hours.

5.11 Depending on the market model or the type and size of orders in the cases defined in the Commission Regulation, the MFSA may waive the obligation for the operator of an MTF to make public the information referred to in SLC 5.10. In particular, the MFSA may waive the obligation in respect of transactions that are large in scale compared with normal market size for the share or type of share in question. Such waiver may be granted by the MFSA following a written request from the MTF

operator to the MFSA which request should include relevant details as necessary.

5.12 In complying with the provisions of this Section of these rules the operators of an MTF shall also comply with the applicable provisions of the Commission Regulation.

Post-trade transparency requirements for MTFs

5.13 The operator of an MTF shall make public the price, volume and time of the transactions executed under its systems in respect of shares which are admitted to trading on a regulated market. The details of all such transactions shall be made public, on a reasonable commercial basis, as close to real-time as possible. Provided that this SLC shall not apply to details of trades executed on an MTF that are made public under the systems of a regulated market.

5.14 The MFSA may authorise, subject to the applicable provisions of the Commission Regulation, the operator of an MTF to provide for deferred publication of the details of transactions based on their type or size. In particular, the MFSA may authorise the deferred publication in respect of transactions that are large in scale compared with the normal market size for that share or that class of shares.

MTFs shall obtain the MFSA's prior approval to proposed arrangements for deferred trade-publication. These arrangements shall be clearly disclosed to market participants and the investing public.

5.15 In complying with the provisions of this Section of the Rules the operator of an MTF shall also comply with the applicable provisions of the Commission Regulation.

Transaction Reporting

5.16 An MTF shall submit to the MFSA a daily report of all the transactions carried out in Instruments which are traded on the MTF ('the Transaction Report'). Such a Transaction Report shall contain the information as specified from time to time by the MFSA and shall be submitted in the format specified by the MFSA. Transaction Reports are to be submitted by the MTF to reach the Authority by the end of the business day following that on which the said trades were executed. The MTF will immediately notify the Authority in writing of any circumstance which prevents it from complying with this requirement.

Provisions regarding central counterparty, clearing and settlement arrangements in respect of MTFs

5.17 The operator of an MTF may enter into appropriate arrangements with a central counterparty or clearing house and a settlement system of another Member State with a view to providing for the clearing and/or settlement of some or all trades concluded

by market participants under their systems.

Provided that the MFSA may oppose the use of central counterparty, clearing houses and/or settlement systems in another Member State where this is demonstrably necessary in order to maintain the orderly functioning of that MTF and taking into account the conditions for settlement systems established in Article 34(2) of the MIFID.

6. Supplementary Conditions for a Licence Holder which Qualifies as Systematic Internaliser and for a Licence Holder which execute Off-Market Deals.

6.01 Systematic internalisers in shares shall publish a firm quote in those shares admitted to trading on a regulated market for which they are systematic internalisers and for which there is a liquid market. In the case of shares for which there is not a liquid market, systematic internalisers shall disclose quotes to their clients on request.

Provided that the provisions of this Section of the Rules shall be applicable to systematic internalisers when dealing for sizes up to standard market size. Systematic internalisers that only deal in sizes above standard market size shall not be subject to the provisions of this Section.

6.02 Systematic internalisers may decide the size or sizes at which they will quote. For a particular share, each quote shall include a firm bid and/or offer price or prices for a size or sizes which could be up to standard market size for the class of shares to which the share belongs. The price or prices shall be updated regularly by the systematic internaliser and shall also reflect the prevailing market conditions for that share.

6.03 Shares shall be grouped in classes on the basis of the arithmetic average value of the orders executed in the market for that share. The standard market size for each class of shares shall be a size representative of the arithmetic average value of the orders executed in the market for the shares included in each class of shares.

Provided that the market for each share shall be comprised of all orders executed in the European Union in respect of that share excluding those large in scale compared to normal market size for that share.

6.04 Systematic internalisers shall make public their quotes on a regular and continuous basis during normal trading hours.

Provided that they shall be entitled to update their quotes at any time. Provided further that, under exceptional market conditions, to withdraw their quotes.

6.05 Quotes shall be made public in a manner which is easily accessible to other market participants on a reasonable commercial basis.

6.06 Systematic internalisers shall, in complying with the SLCs 2.54 to 2.71 execute the orders they receive from their Retail Clients in relation to the shares for which they are systematic internalisers at the quoted prices at the time of reception of the order

6.07 Systematic internalisers shall execute the orders they receive from their Professional

Clients in relation to the shares for which they are systematic internalisers at the quoted price at the time of reception of the order. This notwithstanding, they may execute those orders at a better price in justified cases provided that this price falls within a public range close to market conditions and provided that the orders are of a size bigger than the size customarily undertaken by a retail investor.

6.08 Systematic internalisers may execute orders they receive from their Professional Clients at prices different than their quoted ones without having to comply with SLC 6.07 in respect of transactions where execution in several securities is part of one transaction or in respect of orders that are subject to conditions other than the current market price.

6.09 Where a systematic internaliser who quotes only one quote or whose highest quote is lower than the standard market size receives an order from a client of a size bigger than its quotation size, but lower than the standard market size, it may decide to execute that part of the order which exceeds its quotation size, provided that it is executed at the quoted price, except where otherwise permitted under the conditions of SLCs 6.07 and 6.08.

6.10 Where the systematic internaliser is quoting in different sizes and receives an order between those sizes, which it chooses to execute, it shall execute the order at one of the quoted prices in compliance with SLCs 2.72 to 2.81 except where otherwise permitted under the conditions of SLCs 6.07 and 6.08.

6.11 Systematic internalisers may decide, on the basis of their commercial policy and in an objective non-discriminatory way, the investors to whom they give access to their quotes. To that end, there shall be clear standards for governing access to their quotes. Systematic internalisers may refuse to enter into or discontinue business relationships with investors on the basis of commercial considerations such as the investor credit status, the counterparty risk and the final settlement of the transaction.

6.12 In order to limit the risk of being exposed to multiple transactions from the same client, systematic internalisers may limit in a non-discriminatory way the number of transactions from the same client which they undertake to enter at the published conditions. Systematic Internalisers may also in a non-discriminatory way, and in accordance with SLCs 2.72 to 2.81, limit the total number of transactions from different clients at the same time provided that this is allowable only where the number and/or volume of orders sought by clients considerably exceeds the norm**.**

6.13 The Licence Holder which, either on own account or on behalf of clients, concludes off-market deals, shall make public the volume and price of those transactions and the time at which they were concluded. This information shall be made public as close to real-time as possible, on a reasonable commercial basis, and in a manner which is easily accessible to other market participants.

Provided that where the off-market deal is in Instruments traded on a Regulated Market authorised in terms of article 4 the of Financial Markets Act, 1990, the Licence Holder shall be deemed as having complied with this SLC if it satisfies the requirements set in the Financial Markets Act (Off-Market Deals) Regulations, 2007.

Provided further that the MFSA, subject to the applicable provisions of the Commission Regulation, may authorise the Licence Holder to provide for deferred publication of the details of transactions based on their type or size. In particular, the MFSA may authorise the deferred publication in respect of transactions that are large in scale compared with the normal market size for that shares or those classes of shares. The Licence Holder shall obtain the MFSA's prior approval of proposed arrangements for deferred trade-publication, and shall clearly disclose these arrangements to market participants and the investing public.

6.14 In complying with the provisions of this Section of the Rules, the Licence Holder shall also refer and comply with the applicable provisions of the Commission Regulation

7. Financial Resources Requirements, Accounting and Record Keeping

General

7.01 The Licence Holder shall at all times maintain own funds equal to or in excess of its capital resources requirement. This shall constitute the Licence Holder's Financial Resources Requirement.

Provided that the Licence Holder which is a credit institutions licensed in terms of the Banking Act, 1994 or a branch established in Malta of a credit institutions authorised in a EU Member State or EEA State, or of an overseas credit institutions which is subject to prudential requirements at least equivalent to the requirements applicable to Maltese credit institutions, is not subject to the above-mentioned financial resources requirement and needs not prepare and submit any Interim or Annual Financial Return referred to in the SLCs which follow.

7.02 The meaning of own funds and the capital resources requirement applicable to the different categories of Licence Holders, as well as the methodology for calculating a Licence Holder's satisfaction of its Financial Resources Requirement, are set out in Appendix 1.

7.03 The Licence Holder shall comply with any further financial resources requirements set by the MFSA. If the MFSA so determines, the Licence Holder will be given due notice in writing of the additional financial resources requirements which shall be applied.

7.04 The Licence Holder shall immediately advise the MFSA if at any time it is in breach of its Financial Resources Requirement. In this case, the MFSA may, if the circumstances justify it, allow the Licence Holder a limited period within which to restore its financial resources to the required level.

7.04A The Licence Holder shall ensure compliance with this section of the Investment Services Rules for Investment Services Providers and Appendix 1 to these Rules. A Licence Holder which is found to be in breach of these requirements may be subject to regulatory action in terms of Article 136 of Directive 2006/48/EC of the European Parliament and the Council relating to the taking up and pursuit of the business of credit institutions.

Professional Indemnity Insurance Requirement

7.05 The Licence Holder shall take out and maintain such insurance cover as it considers appropriate. The following mandatory requirements shall however apply to:

i. Licence Holders (except for Category 1) shall be required to maintain such

insurance policies of such classes and types to provide (unless otherwise agreed with the MFSA), at least the minimum level of protection set out in Section 2 of Appendix 6 to these Rules);

ii. A Category 1b Licence Holder having chosen the option to maintain professional indemnity insurance (instead of the option to comply with the financial resources and reporting requirements applicable to Category 1a Licence Holders) shall take out and maintain professional indemnity insurance to provide at least the minimum level of protection set out in Section 1 of Appendix 6 of these Rules.

A Category 1b Licence Holder subject to the professional indemnity insurance requirement, shall submit a copy of its policy to the MFSA for approval, whilst a licence holder falling under (a) above, shall submit a copy of its money policy to the MFSA for its approval.

For the purposes of demonstrating to the satisfaction of the MFSA that the requirements in (a) to (b) above are being complied with on an on-going basis, the Licence Holder shall within one month from the date of renewal of the policy submit to the MFSA, a copy of the renewal cover note or such other written evidence as the MFSA may require to establish compliance with these Rules.

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

a. during the currency of a policy, the Licence Holder has notified insurers of an incident which may give rise to a claim under the policy;

b. during the currency of a policy, the insurer has cancelled the policy or has notified its intention of doing so;

c. the policy has not been renewed or has been cancelled and another policy satisfying the requirements of Appendix 6 has not been taken out from the day on which the previous policy lapsed or was cancelled;

d. during the currency of a policy, the terms or conditions are altered in any manner so that the policy no longer satisfies the requirements of Appendix 6;

e. the insurer has intimated that it intends to decline to indemnify the insured in respect of a claim under the policy;

f. the insurer has given notice that the policy will not be renewed or will not be renewed in a form which will enable the policy to satisfy the requirements of Appendix 6;

g. during the currency of a policy, the risks covered by the policy, or the conditions or terms relating thereto, are altered in any manner.

An Investment Services Licence Holder which is also licensed in terms of the Banking Act, 1994 and its subsidiaries, need not comply with the requirements of this Licence Condition, but instead shall provide MFSA with a brief summary of the nature and amount of its insurance cover.

Accounting / Record Keeping

7.06 The Licence Holder shall maintain proper accounting records to show and explain the Licence Holder's own transactions, assets and liabilities.

7.07 The accounting records shall:

a. disclose with reasonable accuracy, at all times, the financial position of the Licence Holder; and

b. enable the financial statements required by the MFSA to be prepared within the time limits specified in the conditions of the Investment Services Licence.

7.08 In particular, the financial records shall contain:

a. entries from day to day of all sums of money received and expended and the matters to which they relate;

b. a record of all income and expenses, explaining their nature;

c. a record of all assets and liabilities, including any guarantees, contingent liabilities or other financial commitments; and

d. entries from day to day of all transactions on the Licence Holder's own account.

7.09 The Licence Holder shall retain accounting records for a minimum period of ten years. During the first two years they shall be kept in a place from which they can be produced within 24 hours of their being requested.

7.10 The Licence Holder shall agree with the MFSA its Accounting Reference Date (financial year end).

Customers' Accounting Records

7.11 The Licence Holder shall ensure that proper accounting records are kept to show and

explain transactions processed by the Licence Holder on behalf of its customers.

7.12 The records shall:

a. record all purchases and sales of Customers' Assets processed by the Licence Holder;

b. record all receipts and payments of money belonging to customers which arise from transactions processed by the Licence Holder;

c. disclose the assets and liabilities of a Licence Holder's customers individually and collectively, to the extent that they are managed by the Licence Holder;

d. record all Customers' Assets (including title documents) in the possession of the Licence Holder or of another person who is holding such assets for, or to the order of the Licence Holder, showing the location of the assets, their beneficial owner and the extent to which they are subject to any charge of which the Licence Holder has been notified.

7.13 Customers' accounting records shall be retained for a minimum period of ten years.

During the first two years they shall be kept in a place from which they can be produced within 24 hours of their being requested.

7.14 The Licence Holder shall arrange for records to be kept of all services and transactions undertaken by it which shall be sufficient to enable MFSA to monitor compliance with the requirements of these rules, and in particular to ascertain that the Licence Holder has complied with all obligations with respect to clients or potential clients.

Reporting Requirements

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

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

7.16 The Annual Financial Return shall be submitted to the MFSA within one month of

the Accounting Reference Date.

7.17 Audited annual financial statements prepared in accordance with International Financial Reporting Standards, together with a copy of the auditors' management letter and the auditors' report required by SLC 7.32, shall be submitted to the MFSA within four months of the Accounting Reference Date.

7.18 In addition to the Annual Financial Return and the audited annual financial statements, a Category 1 Licence Holder shall prepare an Interim Financial Return, in the form set out in Appendix 2, at a date six months after the Accounting Reference Date. In the event of a change to the Accounting Reference Date, the date for the preparation of the Interim Financial Return shall be agreed with the MFSA.

7.19 In addition to the Annual Financial Return and audited annual financial statements, Category 2 and Category 4 Licence Holders shall prepare an Interim Financial Return, in the form set out in Appendix 2, at dates three, six and nine months after the Accounting Reference Date. The first Interim Financial Return should cover the three months immediately following the Accounting Reference Date, the second Interim Financial Return should cover the six months immediately following the Accounting Reference Date and the third Interim Financial Return should cover the nine months immediately following the Accounting Reference Date. In the event of a change to the Accounting Reference Date, the dates for the preparation of the Interim Financial Returns shall be agreed with the MFSA.

7.20 In addition to the Annual Financial Return and audited annual financial statements, a Category 3 Licence Holder shall prepare an Interim Financial Return, in the form set out in Appendix 2, on a monthly basis. The first Interim Financial Return should cover the first month after the Accounting Reference Date, the second Interim Financial Return should cover first two months after the Accounting Reference Date and so on. In the event of a change to the Accounting Reference Date, the dates for the preparation of the Interim Financial Returns shall be agreed with the MFSA.

7.21 The Interim Financial Return shall be submitted to the MFSA within one month of the date up to which it has been prepared. It shall be signed by the proprietor where the Licence Holder is a sole trader, or otherwise by at least two directors or partners or any other persons authorised to sign by way of a Board Resolution. In the latter case, the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA.

7.22 The Licence Holder shall prepare and submit such additional financial returns as the MFSA may require.

7.23 The Licence Holder shall be responsible for the correct compilation of the Financial Returns. The nature and content of the financial returns shall be as follows:

a. they shall be in the form set out in Appendix 2;

b. they shall be in agreement with the underlying accounting records;

c. accounting policies shall be consistent with those adopted in the audited annual financial statements and shall be consistently applied. These accounting policies should adequately cater for the following:

i. amounts in respect of items representing assets or income may not be offset against amounts in respect of items representing liabilities or expenditure, as the case may be, or vice versa, unless duly authorised by the MFSA; and

ii. balances representing clients' money and/ or assets held/ controlled by the Licence Holder must not form part of the Licence Holder's Balance Sheet;

d. information to be included in the financial returns shall be prepared in accordance with International Financial Reporting Standards;

e. investments shall be included in the balance sheet at valuations arrived at in accordance with the provisions of International Financial Reporting Standards;

f. financial returns shall not be misleading as a result of the misrepresentation or omission or miscalculation of any material item;

g. where the Annual Financial Return has been submitted before the relevant audited annual financial statements have been produced it shall be updated to reflect the information in the audited financial statements and submitted to the MFSA together with the audited annual financial statements;

h. in the case of an individual or individuals in partnership or association, financial returns shall be prepared to show relevant figures for the Investment Services business exclusively. If required by the MFSA to do so, the individual (or individuals) shall submit, in addition, a statement of personal assets and liabilities.

7.24 If so notified in writing by the MFSA, the Licence Holder shall be required to prepare and submit additional financial information for the purposes of consolidated supervision.

7.25 The Licence Holder shall notify the MFSA immediately it becomes aware:

a. that it is in breach of the requirements in respect of financial resources, records, reporting or procedures and controls;

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

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

7.26 The Licence Holder shall notify the MFSA immediately if:

a. it is notified that its auditor intends to qualify the audit report;

b. it becomes aware of actual or intended legal proceedings against it;

c. it decides to claim on a professional indemnity or other policy relating to its Investment Services business;

d. the Licence Holder's counterparties in repurchase and reverse repurchase agreements or securities and commodities-lending and securities and commodities-borrowing transactions default on their obligations.

Audit

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

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

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

a. a director, partner, qualifying shareholder, officer, representative or employee of the Licence Holder;

b. a partner of, or in the employment of, any person in (a) above;

c. a spouse, parent, step-parent, child, step-child or other close relative of any person in (a) above;

d. a person who is not otherwise independent of the Licence Holder;

e. person disqualified by the MFSA from acting as an auditor of a Licence Holder.

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

7.29 The Licence Holder shall obtain from its auditor a signed letter of engagement defining clearly the extent of the auditor's responsibilities and the terms of his appointment. The Licence Holder shall confirm in writing to its auditor its agreement to the terms in the letter of engagement. The auditor shall provide the MFSA with a letter of confirmation in the form set out in Annex II to the Application Form for an Investment Services Licence (whether the Applicant is a Corporate entity or a Sole Trader).

7.30 The letter of engagement shall include terms requiring the auditor:

a. to provide such information or verification to the MFSA as the MFSA may request;

b. to afford another auditor all such assistance as he may require;

c. to vacate his office if he becomes disqualified to act as auditor for any reason;

d. if he resigns, or is removed or not reappointed, to advise the MFSA of that fact and of the reasons for his ceasing to hold office. The auditor shall also be required to advise the MFSA if there are matters he considers should be brought to the attention of the MFSA;

e. in accordance with article 18 of the Act, to report immediately to the MFSA any fact or decision of which he becomes aware in his capacity as auditor of the Licence Holder which:

i. is likely to lead to a serious qualification or refusal of his audit report on the accounts of the Licence Holder; or

ii. constitutes or is likely to constitute a material breach of the legal and regulatory requirements applicable to the Licence Holder in or under the Act;

iii. gravely impairs the ability of the Licence Holder to continue as a going concern; or

iv. relates to any other matter which has been prescribed.

f. in accordance with article 18 of the Act, to report to the MFSA any facts or decision as specified in (e) above of any person having close links, as defined in Appendix 9, with the Licence Holder, of which the auditor becomes aware

in his capacity as auditor of the Licence Holder or of the person having such close links.

7.31 If at any time the Licence Holder fails to have an auditor in office for a period exceeding four weeks the MFSA shall be entitled to appoint a person to fill the vacancy; the fees and charges so incurred being payable by the Licence Holder.

7.32 In respect of each annual accounting period, the Licence Holder shall require its auditor to prepare a management letter in accordance with International Standards on Auditing. The auditor must also confirm to the MFSA that the audit has been conducted in accordance with International Standards on Auditing and whether, in the auditor's opinion:

a. the Annual Financial Return together with the audited annual financial statements are in agreement with the Licence Holder's accounting records;

b. the Annual Financial Return has been prepared in accordance with the MFSA's requirements and is consistent with the audited annual financial statements;

c. the Licence Holder's Financial Resources have been properly calculated in accordance with the MFSA's requirements and exceed the Licence Holder's Financial Resources Requirement as at the Accounting Reference Date;

d. proper accounting records have been kept, and adequate systems for their control have been maintained, as required by the MFSA, during the period covered by the Annual Financial Return;

e. i. the Licence Holder has maintained throughout the period covered by the Annual Financial Return, systems adequate to safeguard Customers' Assets and Clients' Money; or

ii. based on review procedures performed, nothing has come to the auditor's attention that causes the auditor to believe that the Licence Holder held Customers' Assets or Clients' Money during the period covered by the Annual Financial Return.

f. all information and explanations necessary for the purpose of the audit have been obtained.

7.33 Where, in the auditor's opinion, one or more of the requirements have not been met, the auditor shall be required to include in his report a statement specifying the relevant requirements and the respects in which they have not been met. Where the auditor is unable to form an opinion as to whether the requirements have been met, the auditor shall be required to specify the relevant requirements and the reasons why he has been unable to form an opinion.

7.34 The Licence Holder in receipt of a management letter from its auditor which contains recommendations to remedy any weaknesses identified during the course of the audit, is required to submit to the MFSA by not later than six months from the end of the financial period to which the management letter relates, a statement setting out in detail the manner in which the auditor's recommendations have been/ are being implemented. In the instance where the Licence Holder has not taken / is not taking any action in respect of any one or more recommendations in the auditor's management letter, the reasons are to be included.

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

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

Supplementary conditions for a Licence Holder subject to the Investor Compensation Scheme Regulations ("the Regulations") issued in terms of the Act.

7.36 The Licence Holder is required to contribute to the Investor Compensation Scheme ("ICS"), in such manner and within such time limits stipulated in the Regulations, as may be amended from time to time. The Regulations require the Licence Holder to make a Fixed and Variable Contribution.

The Variable Contribution must be computed at every accounting reference date of the Licence Holder. Transfers to the Investor Compensation Scheme Reserve which may be required in terms of the Regulations, are to be made by the Licence Holder when drawing up the annual financial statements, and are to be reflected in the Annual Financial Return. The Licence Holder is not required to make any transfers to the Investor Compensation Scheme Reserve in the Interim Financial Returns.

7.37 The Licence Holder must insert a suitable note in its annual audited financial statements, outlining the market value of the Instruments in which the Investor Compensation Scheme Reserve has been invested, together with a maturity schedule according to the type of Instrument, as appropriate.

7.38 The process leading to a possible claim for compensation payable by the ICS is triggered by a determination which the MFSA shall make to the ICS in accordance with the terms stipulated in the Regulations. The MFSA may consider the following circumstances in arriving at a decision as to whether to make a determination to the ICS in terms of the Regulations. These should be interpreted as merely indicative,

rather than an exhaustive list of such circumstances:

a. a prolonged and recurrent material deficit of the Licence Holder's Financial Resources, where the MFSA is of the opinion that the shareholders are unable to financially support the Licence Holder; or

b. the MFSA is informed of a voluntary winding up of the Licence Holder; or

c. the MFSA has received a complaint from one or more investors to the extent that the Licence Holder was unable to fulfill its obligations arising from claims by such investor(s).

Conditions applicable to a Licence Holder which forms part of an Investment Services consolidation Group.

7.39 The Licence Holder shall, by not later than the end of one month from its accounting reference date, assess whether it forms part of an Investment Services Consolidation Group, as defined in Appendix 3 A to these Rules, and provide the Authority with an explanation to this effect.

7.40 Where the Licence Holder considers that it forms part of an Investment Services Consolidation Group, it shall in turn request its auditor's opinion in this regard, in terms of the definition of an Investment Services Consolidation Group in the Glossary to these Rules. The Licence Holder's auditor shall, in its annual report made in terms of SLC 7.32, provide the MFSA with an opinion as to whether:

a. the Licence Holder forms part of an Investment Services Consolidations Group as defined in the Glossary to these Rules; and

b. the Investment Services Consolidated Group is in surplus or otherwise of the consolidated financial resources requirement.

7.41 The Licence Holder which forms part of an Investment Services Consolidation Group shall ensure that the Investment Services Consolidation Group at all times maintains consolidated own funds which are equal to or in excess of the consolidated capital resources requirement. This shall constitute the Investment Services Consolidation Group's consolidated financial resources requirement.

7.42 The Licence Holder which forms part of an Investment Services Consolidation Group shall prepare an Annual Consolidated Financial Return in the form set out in Appendix 3 B to these Rules. This shall be signed by at least two directors or any other persons authorised to sign by way of a Board Resolution. In the latter case, the Licence Holder is expected to provide a certified true copy of such Board Resolution to the MFSA. The Consolidated Annual Financial Return shall be submitted to the MFSA within one month of the Accounting Reference Date.

7.43 In addition to the Consolidated Annual Financial Return, a Category 2 Licence Holder and a Category 3 Licence Holder which form part of an Investment Services Consolidation Group shall, at a date six months after the Accounting Reference Date, prepare an Interim Consolidated Financial Return. The Consolidated Interim Financial Return shall be submitted to the MFSA within one month of the date up to which it has been prepared. In the event of a change in the Accounting Reference Date, the date for the preparation of the Consolidated Interim Financial Return shall be agreed with the MFSA.

7.44 The Licence Holder shall, where applicable ensure compliance with this section of these Rules and Appendix 3 A thereof. A Licence Holder which is found to be in breach of these requirements may be subject to regulatory action in terms of Article 136 of Directive 2006/48/EC of the European Parliament and the Council relating to the taking up and pursuit of the business of credit institutions.

7.45

8. Transaction Reporting

8.01 The Licence Holder which executes transactions in any Reportable Instrument shall report the details of such transactions to the MFSA. This obligation shall apply whether or not such transactions were carried out on a regulated market. For the avoidance of doubt, such reporting requirement does not apply to the following categories of Investment Services Licence Holders:

i. Licence Holders who merely " receive and transmit orders" by transmitting client's orders to a third party for execution, and who therefore do not actually execute transactions for clients themselves (i.e. they do not deal as agent);

ii. Category 1a, 1b, or 4 Investment Services Licence Holders;

iii. Where the Licence Holder is already subject to a transaction reporting requirement by a Regulated Market or an MTF, in respect of the trade and/or where the Regulated Market or MTF has been entrusted by the MFSA to act as reporting channel;

iv. Where the Licence Holder has a branch in another Member State and carries out the transaction through the said branch on a Regulated Market or MTF in another EU or EEA Member State ("its host State").

Reference to Appendix 8 of these Rules should be made. This contains guidance as to:

a. the applicability of the reporting requirement in different scenarios;

b. the information which such transaction reports shall contain; and

c. the system through which such transaction reports shall be made.

8.02 Transaction Reports shall be submitted as soon as practicable after the execution of the trade as and in any event not later than the close of the following working day. The Licence Holder must notify the MFSA in writing and without delay, of any circumstances which prevent a transaction report being made within the period specified above. This obligation shall apply whether or not such transactions were carried out on a regulated market.

8.03 The Licence Holder shall report such details relating to off-exchange trades which it may execute on behalf of or with clients in relation to Instruments listed and traded on a regulated market or an MTF, as the Regulated Market or MTF may request.

8.04 The Licence Holder shall keep at the disposal of the MFSA, for at least five years, the

relevant data relating to all transactions in Instruments which it has carried out, whether on own account or ob behalf of clients. In the case of transactions carried out on behalf of clients, the records shall contain all the information and details of the identity of the client, and the information required under Council Directive 91/308/EEC of 10 June 1991 on prevention of the use of the financial system for the purposes of money laundering.

8.05 In complying with the provisions of this Section of the Investment Services Rules, the Licence Holder shall also refer and comply with the applicable provisions of Chapter III of the Commission Regulation.

9. Supplementary Conditions for a Custodian of a Collective Investment Scheme.

9.01 The Licence Holder shall be a separate person from the Manager of a Scheme for which it acts as Custodian, and shall act independently of each other and solely in the interests of the Unit Holders. Since independence may be compromised in a variety of ways, any facts, relationships, arrangements, or circumstances which may at any stage bring that independence into question shall be declared to the MFSA as soon as the Licence Holder becomes aware of any such matter.

9.02 The Licence Holder shall have an established place of business in Malta and shall be:

a. a credit institution, constituted and licensed under the laws of Malta; or

b. a branch established in Malta, of a credit institution authorised in a EU Member State or EEA State; or

c. a branch established in Malta of an overseas credit institution which is subject to prudential requirements at least equivalent to the requirements applicable to Maltese credit institutions; or

d. a company incorporated in Malta which is wholly owned by a credit institution, provided that the liabilities of the Licence Holder are guaranteed by the credit institution and the credit institution is either a Maltese credit institution or is an overseas credit institution which is subject to prudential requirements at least equivalent to the requirements applicable to Maltese credit institutions; or

e. a company incorporated in Malta which is wholly owned by a Maltese or foreign institution or company which is deemed by the MFSA to be an institution or company which provides unit-holders with protection equivalent to that provided by a Licence Holder fulfilling the requirements of (a), (b), (c) or (d) above and provided the liabilities of the company acting as Custodian are guaranteed by the institution or company and the institution or company has paid-up share capital of EUR5 million or its equivalent in foreign currency.

In the case of (d) and (e) above, the Licence Holder shall be required to have a minimum of one Director on its Board who is resident in Malta

9.03 The Licence Holder shall have the business organization, systems, and appropriate expertise and experience deemed necessary by the MFSA for it to carry out its functions.

9.04 Neither the Licence Holder nor any of its associates shall deal with the Scheme as a Principal unless the terms of the transaction or arrangement are on an arm's length basis.

9.05 The Licence Holder shall ensure that the sale, issue, repurchase, redemption and cancellation of Units effected by or on behalf of the Scheme are carried out in accordance with MFSA requirements, if any, applicable to the Scheme and with the Scheme's Constitutional Documents and most recent Prospectus.

9.06 The Licence Holder shall, where applicable, supervise the operation of a Scheme to ensure that the Manager complies with the investment restrictions of the Scheme.

9.07 The Licence Holder shall ensure that the value of Units is calculated in accordance with the provisions of the Constitutional Documents and the most recent Prospectus of the Scheme.

9.08 The Licence Holder shall carry out the instructions of the Manager, or the Scheme as applicable, unless they conflict with the MFSA requirements, if any, applicable to the Scheme and with the Scheme's Constitutional Documents and most recent Prospectus.

9.09 The Licence Holder shall ensure that in transactions involving a Scheme's assets, consideration is remitted to it within time limits which are in accordance with accepted market practice in the context of a particular transaction.

9.10 The Licence Holder shall ensure that a Scheme's income is applied in accordance with the Scheme's Constitutional Documents and most recent Prospectus.

9.11 The Licence Holder shall enquire into the conduct of the Manager or the Scheme in each annual accounting period and report thereon to the holders of Units in accordance with MFSA's requirements, if any, applicable to the Scheme and with any applicable provisions of its Agreement with the Scheme or (in the case of a Scheme constituted as a Unit Trust or Common Contractual Fund) its Manager.

9.12 The custodian agreement shall state that the Licence Holder will be liable to the Manager, the Scheme, and to the holders of Units for any loss suffered by them as a result of the Licence Holder's fraud, wilful default or negligence including the unjustifiable failure to perform in whole or in part its obligations.

9.13 The liability of the Licence Holder shall not be diminished if it has entrusted to a third party some or all of the assets in its safe-keeping. This shall be stated in the custodian agreement.

9.14 The Licence Holder shall not enter into a contract for the sale of assets when such assets are not in the ownership of the Scheme

9.15 When servicing a Scheme formed in accordance with or existing under the laws of Malta duly licensed by the MFSA, the Licence Holder shall:

a. advise the MFSA if the value of the Scheme falls below Lm1 million (Euros 2,329,373); and

b. notify the MFSA of any breach of the Scheme's Licence Conditions or of any of the provisions of the Constitutional Documents of the Scheme as soon it becomes aware of the breach.

9.16 The Licence Holder shall notify the MFSA of the intended termination of its appointment to act as custodian of a Scheme.

9.17 The Licence Holder shall comply with the requirements laid out in the Investment Services Act (Control of Assets) Regulations, 1998 as may be amended from time to time.

10. Supplementary Conditions for a Manager of a Collective Investment Scheme

General Conditions applicable to the Licence Holder which qualifies as a Maltese Management Company and to Managers of Non UCITS Schemes

10.01 The Licence Holder shall be a separate person from the Custodian of a Scheme for which it acts as Manager and shall act independently of each other and solely in the interests of the Unit holders. Since independence may be compromised in various ways, any facts, relationships, arrangements or circumstances which arise which may at any stage bring that independence into question shall be declared to the MFSA as soon as the Licence Holder becomes aware of any such matter.

10.02 The Licence Holder shall have an established place of business in Malta. It shall have sufficient financial resources at its disposal to enable it to conduct its business effectively and to meet its liabilities.

10.03 Neither the Licence Holder nor any of its associates shall deal with the Scheme as a Principal unless the terms of the transaction or arrangement are on an arm's length basis.

10.04 The Licence Holder and the Scheme, taking into account all of the Schemes which the former manages, shall not acquire sufficient Instruments to give it the right to exercise control over 20 per cent or more of the share capital or votes of a company, or sufficient Instruments to enable it to exercise significant influence over the management of the issuer.

10.05 The Licence Holder shall comply with directions given by the Custodian, being directions designed to ensure that the Scheme is properly managed and administered in accordance with MFSA requirements, if any, applicable to the Scheme and with the Scheme's Constitutional Documents and most recent Prospectus.

10.06 The Licence Holder shall keep a daily record of its box dealings and the Units held by it. The records shall be available to the Custodian and to the MFSA.

10.07 The Licence Holder shall comply with the External Transactions Act, 2003, in respect of the Scheme and its own operations.

10.08 When servicing a Scheme formed in accordance with or existing under the laws of Malta duly licensed by the MFSA, the Licence Holder shall:

a. advise the MFSA if the value of the Scheme falls below Lm1 million (Euros 2,329,373); and

b. notify the MFSA of any breach of the Scheme's Licence Conditions or of any

of the provisions of the Constitutional Documents of the Scheme as soon it becomes aware of the breach.

c. inform the MFSA immediately, and in any event within the working day, of the temporary suspension of the re-purchase or redemption of the Units of the Scheme.

10.09 The Licence Holder shall be liable to the Scheme and to the holders of Units for any loss suffered by them as a result of the Licence Holder's fraud, wilful default or negligence including the unjustifiable failure to perform in whole or in part its obligations.

10.10 Where the Licence Holder has the responsibility for doing so, the Licence Holder shall issue registered certificates or bearer securities representing one or more portions of the Scheme, or alternatively written confirmation of entry in the register of Units or fractions of Units.

10.11 Where a Scheme invests in the Units of another Scheme managed by the same Licence Holder, the Licence Holder shall waive all charges which it is entitled to charge for its own account in relation to the acquisition or disposal of Units in the Scheme into which investment is made. As far as is practicable, it shall avoid management charges being incurred in respect both of the Scheme and of the underlying Scheme or Schemes.

10.12 Where the Licence Holder receives a commission by virtue of an investment by a Scheme in the Units of another Scheme, that commission shall be paid into the property of the Scheme.

Supplementary Conditions for Managers of Non-UCITS Schemes

10.13 The activities of the Licence Holder shall ordinarily be limited to the management of collective investment schemes. However, the Licence Holder may also, with the approval of the Authority, be allowed to provide other Investment Services.

If the Licence Holder is also authorised to provide investment advice and/or portfolio management services to retail and/or Professional Clients and/or to Eligible Counterparties shall:

a. disclose its interest in any collective investment scheme(s) in respect of which it provides investment advice;

b. in the course of the provision of portfolio management services, not be permitted to invest all or part of the investor's portfolio in units of collective investment schemes it manages or in which it has an interest, unless it receives prior general written consent from the client following disclosure of its interest;

c. not be permitted to provide portfolio management services to any Custodian which performs custodial duties for collective investment schemes in respect of which it acts as Manager.

The Management Company shall not use the Scheme's assets for its own purposes.

10.14 A Collective Investment Scheme may appoint a Manager or a Manager and an Administrator. Where only the Licence Holder is appointed, it shall be responsible for all management and administration functions. Where an Administrator is appointed, the Licence Holder will be responsible for management functions only and the Administrator for administrative functions only.

If an Administrator is not appointed by the Scheme, the Licence Holder may sub-contract the provision of administration services to an Administrator although, responsibility for administration services will in this case be retained by the Licence Holder.

A Licence Holder which sub-contracts the provision of administration services to an Administrator shall remain responsible, on a continuing basis for:

a. the choice and the performance of the Administrator;

b. ensuring that the Administrator is competent and suitable and able to undertake the proposed functions;

c. monitoring the services being provided by the Administrator.

The appointment of an Administrator by the Licence Holder and any change thereto, requires MFSA's prior approval

10.15 In the event that the Manager wishes to delegate to third parties the carrying out on its behalf of one or more of its functions, it shall first notify MFSA. Such notification shall include details of the nature of functions to be delegated and of the entity or entities to whom the Licence Holder proposes to delegate such functions. The Licence Holder will be required to comply with SLCs 4.01 to 4.11.

Supplementary Conditions for a Licence Holder which qualifies as a Maltese Management Company

10.16 The activities of the Licence Holder shall ordinarily be limited to the management of collective investment schemes, which may include the following functions:

– Investment management;

- Administration:
- Legal and fund management accounting services;
- Customer inquiries;
- Valuation and pricing (including tax returns);
- Regulatory compliance monitoring;
- Maintenance of unit-holder register;
- Distribution of income;
- Unit issues and redemptions;
- Contract settlements (including certificate dispatch);
- Record-keeping
- Marketing

However, the Licence Holder, may, with the approval of the MFSA, be allowed to provide the following additional services:

i. discretionary portfolio management services on a client-by-client basis, in relation to one or more Instruments as defined in the Act;

ii. investment advice in relation to one or more Instruments as defined in the Act;

iii. Safekeeping and administration in relation to units of collective investment schemes.

A Licence Holder authorised to provide the advisory and/ or portfolio management services to Retail and/ or Professional Clients and/ or to Eligible Counterparties shall:

a. disclose its interest in any collective investment scheme(s) in respect of which it provides investment advice;

b. in the course of the provision of discretionary portfolio management services, not be permitted to invest all or part of the investor's portfolio in units of collective investment schemes it manages or in which it has an interest, unless it receives prior general written consent from the client following disclosure of its interest;

c. not be permitted to provide discretionary portfolio management services to any Custodian which performs custodial duties for collective investment schemes in respect of which it acts as Manager;

d. comply with the capital adequacy requirements applicable to Licence Holders providing similar Investment Services; and

e. be subject, with regard to the services mentioned above, to the provisions laid down in Directive 97/9/EC 1997 on investor compensation schemes

10.17 The Licence Holder shall at all times maintain own funds equal to or in excess of its capital resources requirement. This shall constitute the Manager's financial resources requirement, in accordance with the relevant requirements set out in Appendix 1.

10.18 The Licence Holder's head office and registered office shall both be located in Malta.

10.19 In the event that the Licence Holder wishes to delegate to third parties the carrying out on its behalf of one or more functions, it shall comply with with SLCs 4.01 to 4.11 and with the following requirements:

a. the Licence Holder shall obtain MFSA's prior consent to the outsourcing or delegation of any of its functions following submission of appropriate details as may be required by the MFSA;

b. the mandate shall not prevent the effectiveness of supervision over the delegate, and in particular it shall not prevent the Licence Holder from acting, or the Scheme from being managed, in the best interests of investors;

c. when the delegation concerns the investment management, the mandate may only be given to undertakings which are authorised or licensed for the purpose of asset management and subject to prudential supervision, and such delegation shall be in accordance with investment-allocation criteria periodically laid down by the Licence Holder;

d. a mandate with regard to the core function of investment management shall not be given to the Custodian or to any undertaking whose interests may conflict with those of the Licence Holder or the unit-holders;

e. measures shall exist which enable the Licence Holder to monitor effectively at any time the activity of the undertaking to which the mandate is given;

f. the mandate shall not prevent the Licence Holder from giving at any time, further instructions to the undertaking to which functions are delegated and to withdraw the mandate with immediate effect when this is in the interest of

investors;

g. having regard to the nature of the functions to be delegated, the undertaking to which functions will be delegated shall be qualified and capable of performing the functions in question; and

In no case shall the liability of the Licence Holder be affected by the fact that it delegated any functions to third parties, nor shall the Licence Holder delegate functions to the extent that it becomes a "letter box/ brass plate" entity.

INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

PART B: STANDARD LICENCE CONDITIONS

Appendix 3 A

Consolidated Financial Resources Requirement and Guidance on the compilation of the Financial Return for Consolidations

This Appendix:

a. details the consolidated financial resources requirement;

b. defines an Investment Services Consolidation Group;

c. lists the scenarios where an Investment Services Consolidation Group is exempt from the consolidated financial resources requirement;

d. lists the undertakings which form part of Investment Services Consolidation Group, which need not be included within the group for the purposes of the consolidated capital requirement;

e. explains the form and extent of consolidation;

f. defines the consolidated capital resources;

g. outlines the components of the consolidated capital resources requirement;

h. explains the manner in which: [i] the components of the financial resources requirement and [ii] the Financial Return for Consolidations which Licence Holders forming part of an Investment Services Consolidation Group are required to submit to the Malta Financial Services Authority in terms of the Investment Services Rules should be completed;

i. lists the supplementary requirements for Licence Holders which are subsidiaries of a financial holding company;

j. outlines the supplementary requirements for mixed activity holding companies; and

k. outlines the co-operation with other competent authorities for the purpose of establishing responsibility for exercising consolidated supervision on a cross-border basis.

1.0 The Consolidated Financial Resources Requirement

1.1 In terms of SLC 7.41 of Part C I of the Investment Services Rules for Investment Services Providers, a Licence Holder which forms part of an Investment Services Consolidation Group is required to ensure that the Investment Services Consolidation Group at all times maintains consolidated own funds which are equal to or in excess of the consolidated capital resources requirement. This shall constitute the Investment Services Consolidation Group's consolidated financial resources requirement.

The MFSA considers consolidated supervision as a complement to and not a substitute for supervision on a solo basis.

2.0 Investment Services Consolidation Group

2.1 An Investment Services Consolidation Group shall exist where a group of companies, which falls within the scope of the term "group" in the Companies Act, 1995 has:

i its parent established in Malta; and
ii at least one of its members that is a Licence Holder and another member that is either:
   a. a credit institution licensed in Malta or outside Malta, being any person carrying on the business of banking, and unless otherwise stated, shall include an electronic money institution (applicable only where the Licence Holder is the parent undertaking and the credit institution is the subsidiary undertaking), or

   b. another Licence Holder, or

   c. a foreign investment services provider, being an entity established outside Malta which carries out activities which are similar to licensable activities carried out by a Licence Holder.

There shall be two forms of an Investment Services Consolidation Group, these being:

i a Local Investment Services Consolidation Group, being a group whose members are all established in Malta**;** and

ii an International Investment Services Consolidation Group, being a group, having one or more of the members established outside Malta.

Unless specified otherwise the term "Investment Services Consolidation Group" shall refer to both a Local Investment Services Consolidation Group and an International Investment Services Consolidation Group.

2.2 Not all members of a group which is an Investment Services Consolidation Group should be considered part of the Investment Services Consolidation Group. Only the following types of entities within a group which is an Investment Services Consolidation Group should be considered as members of the said Investment Services Consolidation Group:

i. Licence Holders and foreign investment services providers;

ii. credit institutions licensed in Malta or outside Malta;

iii. a financial holding company, being a company established in Malta, the sole purpose of which is to acquire holdings in other undertakings and to manage such holdings and turn them to profits, without involving itself directly or indirectly in the management of those undertakings, and this without prejudice to its rights as shareholder; and

iv. a mixed activity holding company, being a holding company, established in Malta, other than a Licence Holder, a credit institution licensed under the Banking Act, 1994 or a financial holding company.

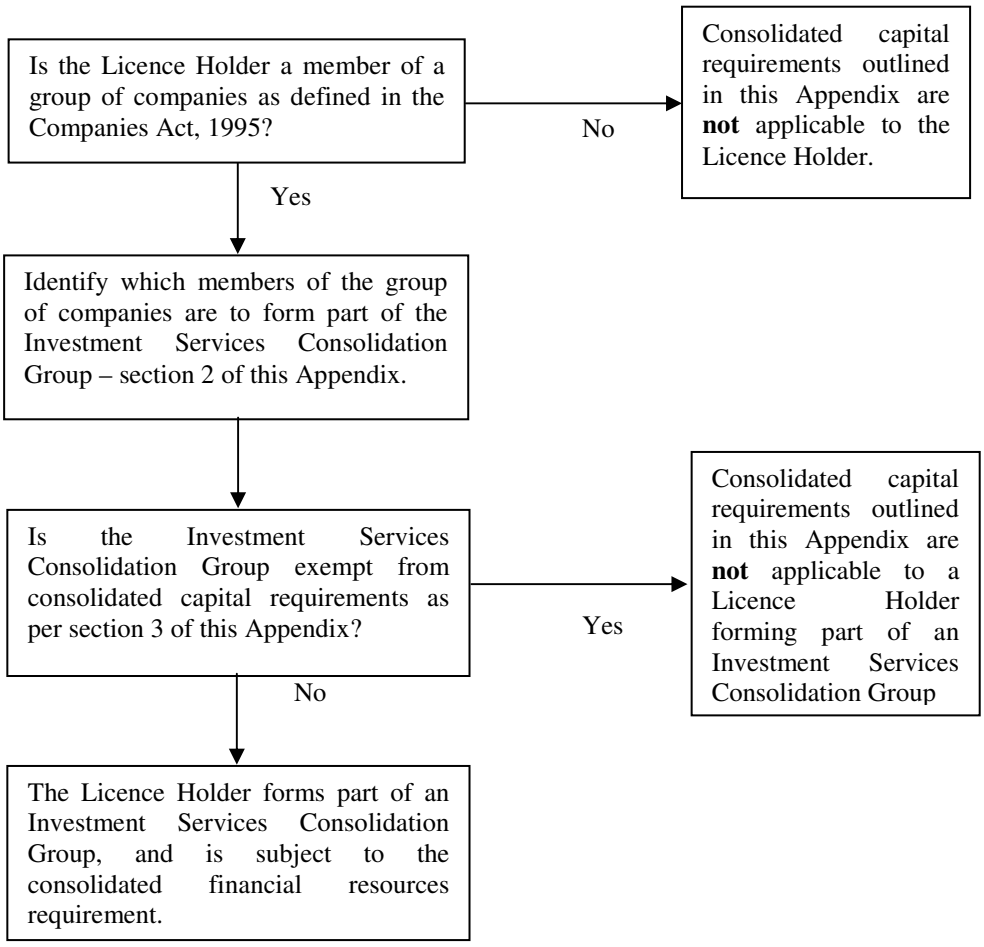
3.0 Exemptions

In the following scenarios, an Investment Services Consolidation Group shall be exempt from the consolidated financial resources requirement:

i. where the only Licence Holder that is a member of the group is solely licensed to act as trustee or custodian in relation to collective investment schemes;

ii. where the only Licence Holder that is a member of the group provides management services in relation to collective investment schemes (excluding a UCITS Manager licensed in terms of the Undertakings for Collective Investment in Transferable Securities Regulations, 2004 as amended);

4.0 Diagram illustrating the manner in which Licence Holders may assess whether they form part of a group which is an Investment Services Consolidation Group:



5.0 List of undertakings which form part of an Investment Services Consolidation Group which need not be included within the group, for the purposes of the consolidated capital requirement

5.1 The MFSA may, upon sufficient evidence being provided by the Licence Holder decide that undertakings which form part of an Investment Services Consolidation Group need not be included within the group for the purposes of the consolidated capital resources requirement, where one or more of the following conditions is/are present:

i. where the member of an International Investment Services Consolidation Group is situated in a country where there are legal impediments for the transfer of information required for consolidated supervision purposes;

ii. where, in the opinion of the MFSA, the member of an Investment Services Consolidation Group concerned is of negligible importance when compared to the activities of the Licence Holder in respect of the objectives of monitoring the Licence Holder and, in any event where the balance sheet total of the member of the Investment Services Consolidation Group is less than the smaller of either the equivalent of EUR 10 million or 1% of the balance sheet total of the parent undertaking or the undertaking holding the participation.

Provided that, if several members of the Investment Services Consolidation Group meet the aforementioned criteria, the MFSA shall require the Licence Holder to ensure that such members are collectively included in the consolidation.

iii. where, in the opinion of the MFSA, consolidation of the financial situation of the member of an Investment Services Consolidation Group would be inappropriate or misleading in so far as supervision on a consolidated basis is concerned.

Provided that where the member of an Investment Services Consolidation Group as referred to [ii] and [iii] above is situated in another Member State, that state in which that member of the Investment Services Consolidation Group is situated may ask the parent of the Investment Services Consolidation Group for information which may facilitate the supervision of that member of the Investment Services Consolidation Group.

5.2 Licence Holders shall seek appropriate authorisation from the MFSA prior to excluding any undertakings as mentioned above from the Investment Services Consolidation Group.

5.3 The MFSA may request the subsidiaries of a group, which is an Investment Services Consolidation Group, which have been excluded from the Investment Services Consolidation Group, to provide the MFSA with any information which would be relevant for the purpose of supervising the members of the Investment Services Consolidation Group.

6.0 Form and extent of consolidation

6.1 The consolidation shall be made in the manner prescribed by International Financial Reporting Standards issued by the International Accounting Standards Board.

Without prejudice to the generality of the above, the MFSA may, at its own discretion, determine whether the accounts of:

i. a Licence Holder that exercises significant influence over another Licence Holder without holding a participation or other capital ties in it, shall be subject to consolidation; and

ii. two or more Licence Holders that are placed under single management other than pursuant to a contract or clauses of their memorandum or articles of association shall be subject to consolidation.

7.0 Consolidated Capital Resources

In terms of SLC 7.41, a Licence Holder which forms part of an Investment Services Consolidation Group shall at all times maintain consolidated own funds which are equal to or in excess of the consolidated capital resources requirement.

7.1 The Consolidated Capital Resources Requirement

The components of the consolidated capital resources requirement vary depending on the category of the Licence Holder which forms part of the Investment Services Consolidation Group. Where two or more Licence Holders holding a different category of licence form part of the same Investment Services Consolidation Group, the capital resources requirement of the Licence Holder with the highest category of licence, shall prevail. The following summarise the components of the consolidated capital resources requirement:

A. Category 1a, 1b and Category 2 Licence Holders

The Capital Resources Requirement shall be the higher of the following:

i. the sum of the consolidated non-trading book business risk components, the consolidated trading book business risk components, the consolidated commodities instruments - risk component, the large exposures risk component, and the consolidated foreign exchange risk component;

ii. the consolidated fixed overheads requirement.

B. Category 3 – including Operators of MTFs

The Capital Resources Requirement shall be the summation of the consolidated non-trading book business risk components, the consolidated trading book business risk components, the consolidated commodities instruments - risk component, the large exposures risk component, the consolidated foreign exchange risk component and the operational risk component.

Provided that where a credit institution is a subsidiary undertaking of a parent Investment Services Licence Holder, the capital requirements applicable to the credit institution shall be the same as those applicable to Category 3 Licence Holders.

8.0 The components of the financial resources requirement and the computation of the financial return for consolidations

This section of the appendix gives a brief description of each of the components of the consolidated financial resources requirement and outlines the manner in which the financial return for consolidations should be completed. It then provides an explanation of how Licence Holders forming part of an Investment Services Consolidation Group are to complete a number of worksheets in the Return, namely:

i. Cover Sheet,
ii. the Input Sheet (Sheet 1),
iii. the Consolidated Income Statement (Sheet 2),
iv. the Consolidated Balance Sheet (Sheet 3),
v. Details – Investment Services Consolidation Group (Sheet 16),
vi. Representations (Sheet 17) and,
vii. Validation Sheet.

Detailed explanations of the:

i. Consolidated Own Funds (Sheet 4),
ii. Consolidated Risk Components (Sheets 5 – 13),
iii. Consolidated Fixed Overheads Requirement (Sheet 14); and
iv. Consolidated Capital Resources Requirement (Sheet 15).

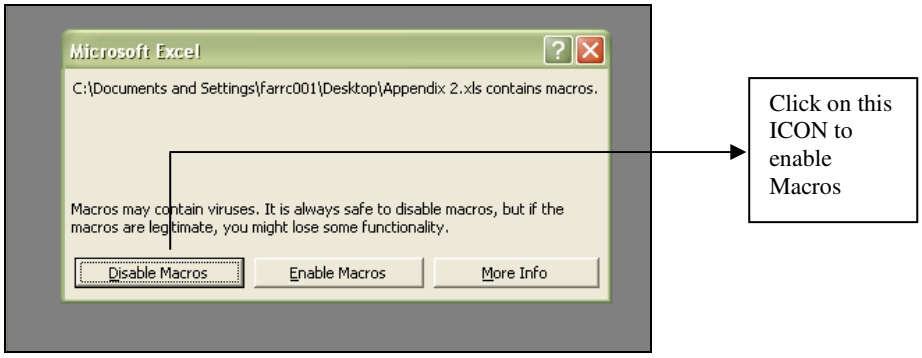
are provided in sections 8.2 to 8.8 of this Appendix.

8.1 Instructions for using the Automated Financial Return for Consolidations

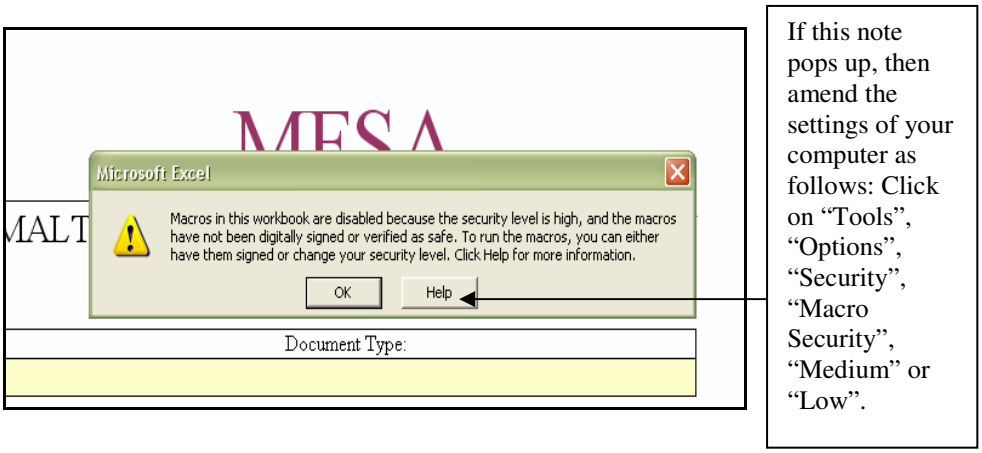
a. This section of the Appendix provides guidance for Investment Services Licence Holders forming part of an Investment Services Consolidation Group when compiling the automated Interim Financial Return for Consolidations ("IFRfC"), the automated Annual Financial Return for Consolidations ("AFRfC") and the automated Annual Audited Financial Return for Consolidations ("AAFRfC"). Unless otherwise specified, the term "Financial Return for Consolidations" and the Rules of the Appendix refer to the IFRfC, AFRfC and AAFRfC.

b. The Financial Return for Consolidations is compiled via an Ms Excel file titled, "APPENDIX 3B.XLS". This file has been optimised for use on Microsoft Excel 2002. Some functions may not work if converted for use with other software or previous versions of Excel. These Excel files are to be retained as Master Copies.

When opening the Excel Spreadsheet named "APPENDIX 3B.XLS" a window will open up which will gives the option to enable the macros. Click on the button "Enable Macros" prior to proceeding with the compilation of the Return.



If a further pop-up window appears on screen, as shown in the figure below, kindly amend the program's settings as described on the next page.



c. Each Financial Return for Consolidations consists of seventeen worksheets. To select a worksheet, go to the "CONTENTS" sheet and click on the button next to the required sheet.

d. The worksheets are password protected. With the exception of cells highlighted in yellow, all cells in this program are locked and only these cells allow the inputting, deleting and amending of values.

e. In instances where the cells are linked, only the values need to be inputted once.

f. Subtotals are calculated automatically.

g. A number of worksheets require manual intervention by being prompted to execute a function or to input a value. Any computer prompted instructions are to be followed carefully.

h. Licence Holders are to provide additional details where required. This is required at the bottom of "SHEETS 2 and 3". Entries should not exceed the space provided for this purpose.

i. A number of worksheets require the Licence Holder to provide supporting documentary evidence of how a particular figure was calculated. Licence Holders are to attach such documents as annexes to the Financial Return for Consolidations and clear reference to the relevant worksheet should be included.

j. The compilation of the automated Financial Return for Consolidations should start from the first worksheet (that is, the "COVER SHEET"). Details should be inserted (as and where appropriate) starting from the top and moving to the end of each worksheet.

k. The following is an outline of all the applicable sheets together with an indication of which sheets require manual input and those which are fully automated:

Sheet	**Sheet title**	**Action to be taken**
Cover Sheet		Manual Input (mandatory)
Contents Sheet	**Contents**	N/A
Sheet 1	**Input Sheet**	Manual Input (mandatory)

Sheet	Sheet title	Action to be taken
Sheet 2	**Consolidated Income Statement**	Manual Input (where applicable)
Sheet 3	**Consolidated Balance Sheet**	Manual Input (where applicable)
Sheet 4	**Consolidated Total Own Funds Calculation**	Manual Input (where applicable)
Sheet 5	**Consolidated Credit/Counterparty Risk**	Fully Automated
Sheet 6	**Consolidated Position Risk Component** Traded Debt Instruments (Specific Risk Component)	Manual Input (where applicable)
Sheet 7	**Consolidated Position Risk Component** Traded Debt Instruments (General Risk Component)	Fully Automated
Sheet 8	**Consolidated Position Risk Component** Equity	Manual Input (where applicable)
Sheet 9	**Consolidated Position Risk Component** Collective Investment Schemes	Manual Input (where applicable)
Sheet 10	**Consolidated Settlement Risk Component**	Fully Automated

Sheet	Sheet title	Action to be taken
Sheet 11	**Consolidated Free Deliveries**	Fully Automated
Sheet 12	**Large Exposures Risk Component**	Manual Input (where applicable)
Sheet 13	**Consolidated Foreign Exchange Risk Component**	Manual Input (where applicable)
Sheet 14	**Consolidated Fixed Overhead Requirement**	Fully Automated
Sheet 15	**Consolidated Capital Resources Requirement**	Manual Input (where applicable)
Sheet 16	**Financial Details – Investment Services Consolidation Group**	Manual Input (mandatory)
Sheet 17	**Representations**	Manual Input (mandatory)
Validation Sheet		Fully Automated

l. For ease of reference, the sheets which require manual input have been marked in blue in the "CONTENTS" Sheet.

m. Users should not key in "0" or "-" whenever a value is nil but should leave the cell empty.

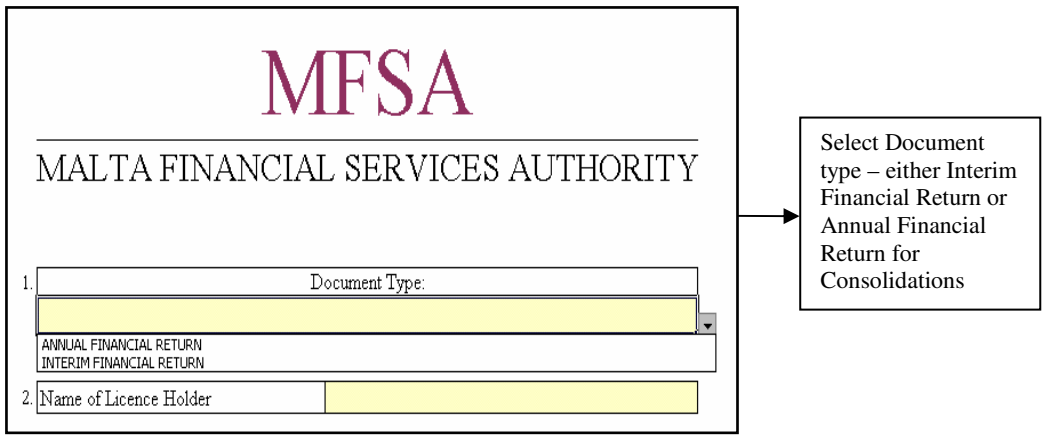
n. Only the worksheets which are marked in red in the "CONTENTS" sheet must be printed.

o. Financial Returns for Consolidations should be submitted by their due date in both hardcopy (signed) and electronic format (by diskette, compact disc or e-mail). Please note that the submission of Financial Returns for Consolidations by e-mail is at the Licence Holder's own discretion and risk (since communications by e-mail may not be secure).

8.1.1 Cover Sheet

a. All cells in items 1 to 6 which are highlighted in yellow are to be completed.

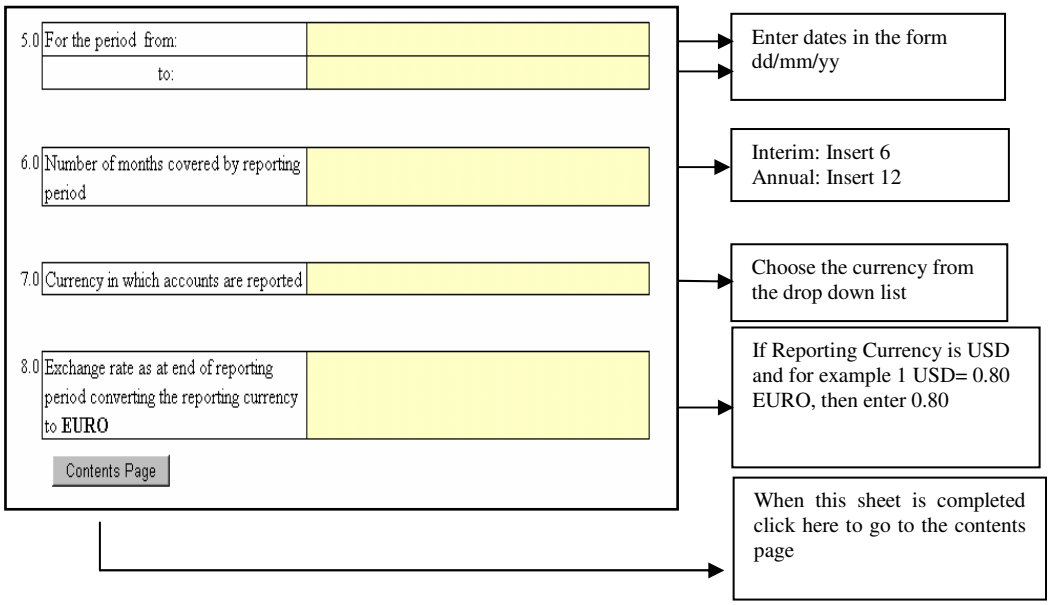
b. *Item 1*: Select document type – either Annual or Interim Financial Return for Consolidations – from the drop down list depending on the period for which the Financial Return for Consolidations is being compiled.



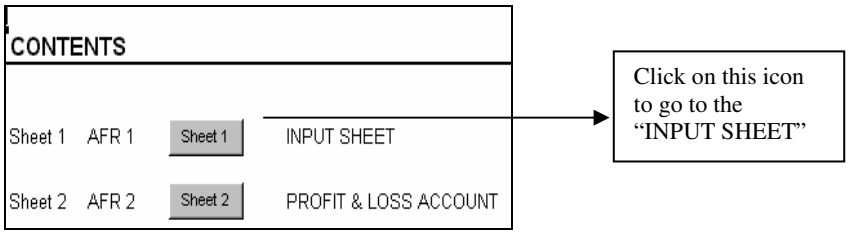
c. Financial Returns for Consolidations are to be prepared in the currency in which the Consolidated Audited Annual Financial Statements are compiled. The Reporting Currency of the accounts should be inserted in ISO Code.

d. Irrespective of the Reporting Currency, the relevant Middle Exchange Rate converting EUR to the Reporting Currency is to be inserted in Item 6.

e. Upon satisfactory completion of items 1 – 6, click on the button "Contents Page" at the bottom of this sheet to go to the "Contents Sheet".



8.1.2 Input Sheet – Sheet 1



a. Click on the button "SHEET 1" in the 'Contents Sheet' to go to the "INPUT SHEET".

b. The Input Sheet has a similar structure to a Consolidated Trial Balance of an Investment Services Consolidation Group. All amounts on the credit (mainly items of income and liabilities) are to have a negative figure, by inserting a '-' sign before the figure. On the other hand, all the amounts on the debit (mainly assets and expenses) should be indicated as positive by inserting the '+' sign before the figure. If a negative amount is filled in a cell representing an asset, the program will prompt the Licence Holder to insert a positive amount. In general, the Licence Holder will not be allowed to insert a negative amount in a cell representing an asset or an expense. Similarly such Licence Holder will not be allowed to insert a positive amount in a cell representing an item of income or a liability. For convenience, some cells have an automated pop-up window explaining what must be inserted.

c. The "INPUT SHEET" is mainly divided into six sections as follows:

i. Income
ii. Expenditure
iii. Assets
iv. Liabilities
v. Capital & Reserves
vi. Other

d. Under the "Income and Expenditure" sections, the revenue/ expenses earned/ incurred during the reporting period by the Investment Services Consolidation Group to which the Licence Holder forms part are to be included.

(N.B.) Besides providing for taxation in the Annual Consolidated Income statement included in the AFRfC, Licence Holders are also required to provide for taxation in the Consolidated Interim Income statement in the IFRfC.

e. Allowable Commissions and Fees, Item 2 (a) in the "Revenue" section relates to commissions and fees payable, provided they are directly attributable to commissions and fees receivable which are included in total revenue.

f. For the purpose of the IFRS prudential reporting framework report: (i) Unrealised fair value movements on financial instruments which are designated at inception as instruments to be maintained at fair value through the profit and loss account, Item 2(o); (ii)) Unrealised fair value movements on "held for trading" financial instruments, Item 2 (p); (iii) fair value movements on 'available for sale' financial instruments as per IAS 39, Item 2 (t); and (iv) revaluations on property as per IAS 40, Item 2 (u).

g. Exceptional Expenditure, Item 2(c) (i) in the "Expenditure" section are items of expenditure for which the MFSA's no-objection should be sought prior to their inclusion in the Financial Return for Consolidations.

h. Under the "Assets" section, financial instruments, both long and short positions, held on the Investment Services Consolidation Group's (item 3 (d)) balance sheet are to be categorised under one of the available headings. The long or short position in a particular investment is the net of any long or short positions held in that same investment. Short positions in any financial instrument are to be included as positions held with trading intent only. The Licence Holder must include both the balance sheet value and the market value of these financial instruments. Where financial instruments are held at fair values, the Licence Holder must input the market value under both cells. It is important that financial instruments are inserted under their appropriate heading.

i. Collective investment schemes, Item 3 (e) (iii), are any amounts receivable by the Investment Services Consolidation Group from transactions in collective investment schemes.

j. Investment Services Consolidation Group creditors - due within 1 year, Item 4 (c) and Group creditors - due after more than 1 year, Item 4.0 (g). These represent amounts receivable from group companies and/ or connected persons. The definition of "Group" to be considered is that defined in the Companies Act, 1995 and "connected counterparty" as defined in Section 4.2.4 (A) (iii).

k. The Licence Holder must also indicate under Item 6 (a) whether the Investment Services Consolidation Group has any assets or liabilities denominated in a Foreign Currency. If the answer is "YES" the Licence Holder must compile Sheet 13 which deals with Consolidated Foreign Exchange Risk adjustments.

l. Secured Liabilities, Item 6(b). Under item (i), the Licence Holder must include the Investment Services Consolidation Group's total secured liabilities which are due within 1 year. On the other hand, under item (ii) the Licence Holder must insert that part of the amount inserted in (i) which is secured by a charge on land and buildings. Under item (iii), the Licence Holder must include the total secured liabilities which are due after more than 1 year. Similarly, under item (iv) the Licence Holder must insert that part of the amount inserted in (iii) which is secured by a charge on land and buildings.

m. The Licence Holder is to input the relevant figures for items 6(c), 6(d), 6(e), 6(f), 6(g), and 6(i) if these are applicable.

n. The Licence Holder should indicate the consolidated credit/ counterparty risk calculation which has been used in the Financial Return for Consolidations in Item 6 (h).

o. The Licence Holder should indicate under Item 6 (j) whether the Investment Services Consolidation Group holds positions in derivative financial instruments. If the answer is "YES" the Licence Holder should refer to para. 4.2.2.1 of Appendix 1 to these Rules and include the total Derivative Risk component in Sheet 15 item 3(a).

p. If the Investment Services Consolidation Group held positions in commodities during the reporting period, then Item 6 (k) should be marked as "YES". The Licence Holder should refer to para. 4.2.3 of Appendix 1 to these Rules and include the total Consolidated Commodities Instruments - Risk Component in Sheet 15 Item 4.

q. Once the relevant parts of Sections 1 – 6 have been completed click on the button "Print Set-up". Automatically, all those cells which have been left empty will be hidden. After printing this sheet, the user may click on the button "Show all" and all the hidden cells will re-appear. Click on the button "Return to Contents" to return to the contents page.

8.1.3 Consolidated Income Statement – Sheet 2

a. This sheet is fully automated except for Items 8.0 and 20.0.

b. The space provided in Item 8.0 ("Details of 'Other ISA related revenue' and/or Any other details or comments") is to be used to explain Item 5.0 ("Other ISA related revenue").

c. The space provided in Item 20.0 ("Details of Exceptional items of expenditure allowed by MFSA, other variable expenditure and other fixed expenditure") should provide explanations to Item 10.0 (a) ("Exceptional Items of expenditure allowed by MFSA"), item 11.0 (j) ('Other Variable Expenditure') and item 11.0 (k) ('Other Fixed Expenditure').

8.1.4 Consolidated Balance Sheet – Sheet 3

a. This sheet is fully automated except for Item 12.0.

b. The space provided in Item 12.0 ("Details of 'Amounts due to/ from other connected persons' and/or 'Amounts due to/ from Group Companies' and/or Any other details or comments") should include explanations to the following Items:

i. Item 3.0(c) (*"Amounts due from Group Companies"*)
ii. Item 3.0(d) (*"Amounts due from other connected persons"*)
iii. Item 4.0(c) (*"Amounts due to Group Companies – within 1 year"*)
iv. Item 4.0(d) (*"Amounts due to other connected persons – within 1 year"*)
v. Item 7.0(b) (*"Amounts due to Group Companies – after more than 1 year"*)
vi. Item 7.0(c) (*"Amounts due to other connected persons – after more than 1 year"*)

8.1.5 Sheet 16 – Details - Investment Services Consolidation Group

a. Where applicable, all the cells marked in yellow are to be inputted.

b. Some cells enable the user to select a reply from a drop down menu.

c. The Licence Holder should ensure that all details relating to the parent undertaking and subsidiary undertakings are included.

d. The Licence Holder may add further details/comments in item 3 of this Sheet.

8.1.6 Sheet 17 – Representations

a. Items 1 – 3 of this sheet must be filled by the Licence Holder.

b. The date when the Licence Holder approved the Financial Return for Consolidations is to be inputted in item 4.

c. The Financial Return for Consolidations is to be signed by two Directors or other authorised signatories. When the Financial Return for Consolidations is signed by the latter, the Licence Holder should provide a certified true copy of the Board of Directors' Resolution authorising the individual to sign the Return on behalf of the Directors.

8.1.7 Validation Sheet

Prior to submitting the Financial Return for Consolidations to the MFSA, the Licence Holder must ensure that all Validations are marked "OK". Where the Validation is marked "ERROR", the Licence Holder should check and correct the relevant sheet accordingly.

8.2 Consolidated Own Funds

Consolidated Own Funds means the sum of tier one capital, tier two capital and tier three capital.

For the purposes of the Consolidated Total Own Funds computation, the Licence Holder shall treat an Investment Services Consolidation Group as a single undertaking and calculate Own Funds on an accounting consolidation basis. In this respect, Consolidated Own Funds Calculation shall be based on the figures of the Consolidated Income Statements, Consolidated Statement of Changes in Equity and Consolidated Balance Sheet. Definitions of the three tiers of capital and the components of tier one, tier two and tier three capital are provided in section 4.1 of Appendix 1 to these Rules.

8.2.1 Restrictions on Consolidated Own Funds

a. Consolidated non-core tier one capital is to be **less than 50%** of total consolidated tier one capital after deductions;

b. Total consolidated tier two capital **must at all times be less** than consolidated total tier one capital after deductions;

c. Consolidated lower tier two capital **must at all times be less than 50%** of total consolidated tier one capital after deductions; and

d. Total tier two capital after deductions and tier three capital must **at all times be less than 200%** of total tier one capital after deductions

Licence Holders must ensure that at all times the Investment Services Consolidation Group meets the above conditions. Should the Investment Services Consolidation Group be in breach of any of the above conditions, the MFSA is to be immediately notified.

8.2.2 The section on Own Funds of the Financial Return For Consolidation

Sheet 4 – (Own Funds) of the Financial Return For Consolidations, which calculates the Investment Services Consolidation Group's own funds, is fully automated and does not require any form of manual intervention in the case where the Standardised Approach to credit/counterparty risk is used by the Investment Services Consolidation Group.

The Licence Holder is to ensure that items 1.0 – 3.0 in the section "OWN FUNDS WARNINGS", section of Sheet 4 are in order. This ensures that any of the restrictions listed in para. 8.2.1 have not been exceeded. Where the Investment Services Consolidation Group exceeds the restrictions on Own Funds, the Licence Holder should inform the MFSA of the action which will be taken to reduce this exposure.

8.2.3 Risks associated with non-trading book business

This category is made up of the consolidated credit/ counterparty risk component, being the possibility of a loss occurring due to:

a. the failure of a debtor of the group to meet its contractual debt obligations; or
b. the loss in value of any other asset which forms part of the consolidated balance sheet.

8.2.4 Measuring the Consolidated Credit/Counterparty Risk

The consolidated credit/ counterparty risk can be measured through any one of the following three methods: (i) the Standardised Approach, (ii) the Foundation Internal Ratings Based Approach (FIRB) or (iii) the Advanced Internal Ratings Based Approach (AIRB).

N.B.1. For an explanation of the Standardised Approach to the calculation of the credit/counterparty risk component, please refer to section 4.2.1.1 of Appendix 1 to these Rules. The computation of the consolidated credit/counterparty risk is the same as the credit/counterparty risk applied on a solo basis.

N.B.2. These Rules and the Financial Return for Consolidations cater for the Standardised Approach. The FIRB and the AIRB approaches are based on the Licence Holder's assessments of the risks to which it is exposed. It is strongly recommended that MFSA's guidance is sought prior to adopting these alternative methods, which methods are to be approved by the MFSA.

8.3 Risks associated with trading book business

This category is made up of four risk components:

8.3.1 The consolidated position risk component

The consolidated position risk component is defined as the risk of losses, arising from movements in market prices, in on and off balance sheet investments in financial instruments which qualify as trading book business. Please refer to section 2 of Appendix 1 to these Rules for a comprehensive definition of trading book and its elements. For the purpose of the calculation of position risk, financial instruments are categorised under one of the following titles: (i) Traded Debt Instruments; (ii) Traded Equities; (iii) Collective Investment Schemes; and (iv) Derivatives. The methodology for computing the consolidated position risk component calculation is the same as that outlined in section 4.2.2.1 of Appendix 1 to these Rules.

N.B. These Rules and the Financial Return for Consolidations cater for the calculation of the consolidated position risk component of all types of financial instruments except for derivatives. As it is generally the exception that Licence Holders invest in

derivatives, MFSA has taken the approach that the calculation of the risk related to investments in such assets may be catered for on a case by case basis. Licence Holders which form part of an Investment Services Consolidation Group which invest in derivatives should contact the MFSA for guidance as to how the derivatives related consolidated position risk component should be catered for in the Financial Return for Consolidations.

8.3.1.1 Measuring the Consolidated Position Risk Component

The methodology for measuring the position risk component varies depending on the type of financial instrument. The methodology for the calculation of the consolidated position risk is the same as that applied for the position risk on a solo basis. Please refer to section 4.2.2.1 (A) and (B) of Appendix 1 to these Rules for a detailed explanation of how position risk is to be measured and the steps to be followed in the Financial Return for Consolidations when compiling the consolidated position risk component for the various types of financial instruments.

8.3.2 The consolidated settlement risk component

Settlement risk is the risk that cash against documents transactions in financial instruments undertaken by members of an Investment Services Consolidation Group, which qualify as trading book business are unsettled after their due delivery dates. The settlement risk component calculation for an Investment Services Consolidation Group is the same as that applied for the settlement risk component on a solo basis. Measurement of this risk component and the steps to be followed in the Financial Return for Consolidations are illustrated in section 4.2.2.2 of Appendix 1 to these Rules.

8.3.3 The consolidated counterparty risk component

Counterparty risk is the amount of capital which any of the members within the Investment Services Consolidations Group hold against exposures in financial derivative instruments and credit derivatives.

N.B. These Rules and the Financial Return for Consolidations cater for the calculation of the trading book business Counterparty Risk Component. As it is generally the exception that Licence Holders invest in derivatives, the MFSA has taken the approach that the calculation of the counter party risk related to investments in such assets may be catered for on a case by case basis. Licence Holders who invest in derivatives should contact the MFSA for guidance as to how the counterparty risk component should be calculated and catered for in the Financial Return for Consolidations.

8.3.4 Consolidated Free deliveries

Free Deliveries caters for the risk that the Licence Holder has either: (a) paid for free deliveries transactions in financial instruments which qualify as trading book business before receiving them; or (b) has delivered financial instruments which qualify as

trading book business, sold in a free deliveries transaction, before receiving payment for them. The free deliveries risk component calculation for an Investment Services Consolidation Group is the same as that applied for the free deliveries risk component on a solo basis. Measurement of this risk component and the steps to be followed in the Financial Return for Consolidations are illustrated in section 4.2.2.4 of Appendix 1 to these Rules.

8.4 Commodities Instruments - Risk Component

Commodities Risk is the risk component required to cover the risk associated with the holding or taking positions, by a member/s of an Investment Services Consolidation Group, in commodities such as physical products which are and can be traded in the secondary market including commodity derivatives. The commodities instruments – risk component calculation for an Investment Services Consolidation Group is the same as that applied for this risk component when calculated on a solo basis. Measurement of this risk component and the steps to be followed in the Financial Return for Consolidations are illustrated in section 4.2.3 of Appendix 1 to these Rules.

8.5 Large Exposures Risk Component

The purpose of the large exposure requirement is to ensure that an Investment Services Consolidation Group manages its exposure to counterparties within appropriate limits set in relation to its capital resources requirements. A large exposure may be in the form of a loan to a single borrower, or it may arise across many transactions involving different types of financial instruments with several counterparties.

A large exposure means the exposure by an Investment Services Consolidation Group to: (a) an individual counterparty; (b) connected counterparties; or (c) a group of connected clients (all three terms are defined in point (A) of section 4.2.4 of Appendix 1 to these Rules).

8.5.1 <u>Condition regarding Individual Large Exposures</u>

Exposures by an Investment Services Consolidation Group to any class of the above-mentioned categories of counterparties should not exceed 25% of the Group's Own Funds.

The Consolidated Large Exposures Risk Component shall be the equivalent of the summation of the amount which is in excess of the above-mentioned limits.

8.5.2 <u>Condition regarding Total Individual Large Exposure</u>

The Investment Services Consolidation Group's individual exposures exceeding 10% of Own Funds are not to exceed 800% of its Own Funds. Licence Holders shall monitor and control their large exposures to ensure that the Investment Services Consolidation Group's total large exposures do not exceed this limit.

N.B. When calculating the consolidated large exposures risk component, any intra group exposures shall not be considered as a large exposure.

The consolidated large exposures risk component calculation for an Investment Services Consolidation Group is the same as that applied for this risk component when calculated on a solo basis. The types of Counterparties, the measurement of this risk component, exempt exposures and the steps to be followed in the Financial Return for Consolidations are illustrated in section 4.2.4 of Appendix 1 to these Rules.

8.6 Foreign Exchange Risk Component

Foreign Exchange Risk is the risk that an asset or liability in the consolidated financial statements of the Investment Services Consolidation Group denominated in a currency other than the reporting currency may be adversely affected by a change in the value of the foreign currency.

N.B. These Rules and the Financial Return for Consolidations provide for the calculation of the Consolidated Foreign Exchange Risk component of all types of asset exposures except for derivatives. As Licence Holders rarely invest in derivatives, MFSA has taken the approach that for the purpose of the Financial Return for Consolidations, the calculation of the risk related to investments in such assets may be catered for on a case by case basis. Investment Services Consolidation Group which undertake transactions in derivatives should contact the MFSA for guidance as to how the derivatives related foreign exchange risk component should be calculated and catered for in the Financial Return for Consolidations.

The consolidated foreign exchange risk component calculation for an Investment Services Consolidation Group is the same as that applied for this risk component when calculated on a solo basis. The manner in which the foreign exchange risk component should be calculated is explained in section 4.2.5 of Appendix 1 to these Rules.

8.7 Consolidated Operational Risk Component

Operational Risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.

The operational risk capital requirement ("ORCR") for a Licence Holder is an amount calculated in accordance with one of the following methods:

a. The Basic Indicator Approach ('BIA');

b. The Standardised Measurement Approach ('SMA'); and

c. The Advanced Measurement Approach ('AMA').

N.B.1 These Rules cater for the Basic Indicator Approach. An explanation on how to apply the SMA and the AMA approaches for ISCGs and the applicable qualifying criteria to use both methods will be provided by the MFSA upon request.

The consolidated operational risk component calculation using the BIA for an ISCG is the same as that applied for the BIA when calculated on a solo basis. The manner in which the consolidated operational risk component should be calculated is explained in section 4.2.6 of Appendix 1 to these Rules.

N.B.2 The Financial Return for Consolidations does not cater for the Consolidated Operational Risk Component. As this requirement only applies to Category 3 Licence Holders, MFSA decided that for the purpose of the Financial Return for Consolidations, the calculation of the operational risk component may be catered for on a case by case basis. Category 3 Licence Holders which form part of an Investment Services Consolidation Group should contact the MFSA for guidance as to how the consolidated operational risk component should be catered for in the Financial Return for Consolidations.

8.8 Consolidated Fixed Overheads Requirement

The fixed overheads requirement shall be calculated by taking, in the case of:

a. the annual figures, one quarter of the Investment Services Consolidation Group's yearly total expenditure after deducting the items of expenditure outlined in point (A) of section 4.3 of Appendix 1 to these Rules; and

b. the half yearly figures by: (a) deducting the items of expenditure outlined in point (A) of section 4.3 of Appendix 1 to these Rules from total expenditure to obtain the relevant expenditure figure; (b) extrapolating the relevant expenditure figure for the half yearly, as applicable, into an annual figure to obtain the pro-rated annualised expenditure figure, and (c) taking one quarter of the pro-rated annualised expenditure figure.

9.0 Supplementary requirements for Licence Holders which are subsidiaries of a Financial Holding Company

The Licence Holder which is a subsidiary of a Financial Holding Company shall ensure that persons who effectively direct the business of a Financial Holding Company are of sufficiently good repute and have sufficient experience to perform these duties.

10.0 Supplementary Requirements for Mixed Activity Holding Companies

10.1 For the purposes of ensuring proper supervision of a Licence Holder which forms part of a group of companies which has a mixed activity holding company as its

parent, the MFSA may request the Licence Holder to provide the MFSA with information about any member of such group of companies, which would be relevant for the purpose of the supervision of the said Licence Holder.

10.2 The MFSA may carry out spot-check inspections to verify information received from the Licence Holder in terms of para 10.1 above.

10.3 Where the Licence Holder forms part of a group of companies which has a mixed activity holding company as its parent, the MFSA shall have the right to exercise general supervision over transactions between members of such group.

10.4 Where the Licence Holder forms part of a group of companies which has a mixed activity holding company as its parent, the Licence Holders shall have in place adequate risk management processes and internal control mechanisms, including sound reporting and accounting procedures, in order to identify, measure, monitor and control transactions with the parent of the group and its subsidiaries. The Licence Holder shall report to the MFSA any significant transactions with other members of the group, which transactions are not reported under the large exposures risk component.

10.5 The MFSA shall take appropriate measures where intra-group transactions between members of group of companies whose parent is a mixed activity holding company are a threat to the Licence Holder's financial position.

11.0 Co-operation with other competent authorities for establishing responsibility for exercising consolidated supervision on a cross-border basis

11.1 Where an Investment Services Consolidation Group forms part of a larger group the parent of which is established outside Malta or where a Licence Holder forms part of group the parent of which is established outside Malta, the MFSA may seek to make appropriate and adequate arrangements, in the manner prescribed in Section 1 of Chapter 4 of Title V of Directive 2006/48/EC, relating to the taking up and pursuit of the business of credit institutions, with the competent authorities of the relevant countries where the parent of the larger international group is situated/established in order to establish the final responsibility for consolidated supervision.

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

INVESTMENT SERVICES RULES FOR INVESTMENT SERVICES PROVIDERS

PART B: STANDARD LICENCE CONDITIONS

Appendix 3 B:
Financial Return for Consolidations

1.0	Document Type:	
2.0	Name of the parent undertaking of the Investment Services Consolidation Group	
3.0	For the period from:	
	to:	
4.0	Number of months covered by reporting period	
5.0	Currency in which accounts are reported	
6.0	Exchange rate as at end of reporting period converting the reporting currency to EURO	

Version 1/2008

N.B.
a) Any of the above Sheet Titles which are marked in blue require manual input.
b) Sheets marked in red must be printed.

For the period from _____ to _____

Amounts included on the credit should be -ve

Amounts included on the debit should be +ve

	As per Trial Balance
1) Income	
a) Dealing Profit or (Loss) - Trading	
b) Dealing Profit or (Loss) - Long Term Investments	
c) Commissions received on transactions in :	
i) locally based schemes	
ii) foreign based schemes	
1) listed on an EU Regulated Market or	
the Regulated Market of a developed financial centre	
2) listed in other markets	
iii) other commissions (equities, debt instruments etc...)	
d) Investment Management and Administration Fees	
i) Retail clients	
ii) Professional clients and eligible counterparties	
iii) Collective Investment Schemes	
iv) Other (e.g. connected companies)	
e) Investment Advisory Fees	
i) Retail clients	
ii) Professional clients and eligible counterparties	
iii) Collective Investment Schemes	
iv) Other (e.g. connected companies)	
f) Other ISA related revenue	
g) Non-ISA related revenue	
2) Expenditure	
a) Allowable commissions and fees	
b) Other Commissions payable	
c) Exceptional Items of expenditure	
i) Allowed by MFSA	
ii) Other	
d) Depreciation	
e) Staff bonuses	
f) Employees' and directors' shares in profits	
g) Interest charges in respect of borrowing made to finance the acquisition of readily realisable investments	
h) Interest paid to clients on clients' money	
i) Interest paid to counterparties	
j) Fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions	
k) Foreign exchange losses	
l) Directors' emoluments	
m) Other variable expenses	
n) Other fixed expenses	
o) Unrealised fair value movements on "Designated at inception at fair value through profit and loss account" financial instruments	
p) Unrealised fair value movements on "Held for trading" financial instruments	
q) Taxation for the year	
r) Other Operating Income/ Charges net of attributable taxation	
Movements reflected through the Consolidated Statement of Changes in Equity	
s) Dividends	
i) Paid	
ii) Proposed but not paid	
t) Unrealised fair value movements on "Available for sale" financial instruments	
u) Unrealised fair value movements on revaluation of property	
v) Other movements through statement of changes in equity	
3) Assets	
a) Intangible assets	
i) Goodwill	
ii) Other Intangible Assets	
b) Tangible assets	

For the period from _____ to _____

i) Land & Buildings	
ii) Other Tangible Assets	
c) Deferred tax Asset	

d) Financial Instruments (Short Positions are to be included as trading book positions only.)

i) Debt securities issued by central governments or central banks

		Insert Market Value	Trading Intent?		Quality Assessment

ii) Debt securities issued by EEA financial services licensed entity

		Insert Market Value	Held with Trading Intent?	No. of months to maturity	Credit Quality Assessment

iii) Debt securities issued by a corporate other than EEA financial services licensed entity

		Insert Market Value	Held with Trading Intent?		Credit Quality Assessment

iv) Other debt instruments which show a particular risk due to insufficient solvency of the issuer of liquidity which form part of the TRADING BOOK ONLY

		Insert Market Value		No. of months to maturity	Credit Quality Assessment	Coupon Rate

v) Units in high risk Collective Investment Schemes

		Insert Market Value	Held with Trading Intent?

vi) Units in other Collective Investment Schemes

		Insert Market Value	Trading Intent?

For the period from _____ to _____

vii) Shares traded on an EU Regulated Market or the regulated market of a developed financial centre		Insert Market Value	Held with Trading Intent?	Connected Company?

viii) Other shares [including investments in venture capital firms and private equity investments]		Insert Market Value	Held with Trading Intent?	Connected Company?

ix) Investments in group companies		Insert Market Value	Connected Company?

e) Debtors

i) unsettled securities transactions - cash against documents		Market value of Und Position
0 - 4 working days		
5 - 15 working days		
16 - 30 working days		
31 - 45 working days		
46 or more working days		

ii) unsettled securities transactions - free deliveries

a) if securities were delivered

1) Up to first contractual payment	
2) From first contractual payment to four days after second contractual payment.	
3) From 5 business days post contractual payment until extinction of transaction	

For the period from [ ] to [ ]

		Market value of Underlying Position
b) if securities were paid for by the Licence Holder		
1) Up to first contractual delivery lag		
2) From first contractual delivery lag to four days after		
second contractual delivery lag.		
3) From 5 business days post contractual delivery lag		
until extinction of transaction		
iii) Collective investment schemes		

		Include an amount that the Licence Holder has reason to doubt repayment on demand
iv) Group debtors		
1) Amounts due from group companies		
2) Amounts due from other connected persons		
v) Trade debtors		
f) Prepayments		
g) Accrued income		
h) Amounts receivable from Government bodies		
i) Amounts receivable within 90 days		
ii) Amounts receivable after more than 90 days		
i) Amounts receivable from Financial Institutions		
i) Amounts receivable within 90 days		
ii) Amounts receivable after more than 90 days		
j) Other debtors		
k) Bank and cash balances		
i) Balances which can be withdrawn within 30 days		
ii) Balances which can be withdrawn only after 30 days		

4) Liabilities

a) Tax liability	
b) Overdrafts	
c) Group creditors - due within 1 year	
i) Amounts due to group companies	
ii) Amounts due to other connected persons	
d) Accruals	
e) Other creditors	
f) Loans:	
i) subordinated	
ii) other	
g) Group creditors - due after more than 1 year	
i) Amounts due to group companies	
ii) Amounts due to other connected persons	
h) Other long term liabilities	
i) Deferred Tax Liability	
j) Other provisions for liabilities/ charges	

5) Capital & Reserves

a) Called up ordinary share capital	
b) Perpetual Non-Cumulative Preference Shares	
c) Perpetual Cumulative Preference Shares	
d) Fixed term Non-cumulative preference shares (if not redeemable within 5 years)	
e) Fixed term Non-cumulative preference shares redeemable within 5 years	
f) Fixed term Cumulative Preference Share Capital (if not redeemable within 5 years)	
g) Fixed term Cumulative Preference Share Capital redeemable within 5 years	
h) Investor Compensation Scheme Reserve	
i) Share premium account	
j) Property & financial instruments' revaluation reserves as per the	
previous year's audited financial statements	
k) Revenue reserves as per the previous year's audited financial statements	
l) Other reserves	
m) Minority Interest	
	-

For the period from | to

6) Other

a) Foreign Currency

Does the Investment Services Consolidation Group have assets/ liabilities denominated in a currency other than the reporting currency?	

b) Secured Liabilities

i) Include the amount of secured liabilities - which are due within 1 year	
ii) Include the amount of secured liabilities -which are due within 1 year & secured by a charge on land & building	
iii) Include the amount of secured liabilities - which are due after more than 1 year	
iv) Include in full the amount of secured liabilities - which are due after more than 1 year & secured by a charge on land & building	

c) Contingent Liabilities

Insert the amount of any Contingent Liabilities	

d) Investment in Own Shares

Report own shares held at book value	

e) Material Holding in Credit/ Financial Institutions

Report material (>10%) holding in credit/ financial institutions at book value	

f) Additional Deductions

Report any additional deductions from tier two capital - [please refer to point 4.1 of Appendix I]	

g) Bank and/ or other third party guarantees approved by the MFSA

Include any Bank and/ or other third party guarantees approved by the MFSA	

h) The credit/ counterparty risk calculation method applied by the Investment Services Consolidation Group is:

i) Interim Trading Book Profits/Losses

Include any trading book profits/losses which have not been included in the Income Statement	

j) Derivatives Risk

Did the Investment Services Consolidation Group hold any positions in derivative financial instruments during the reporting period?	

k) Commodities Instruments - Risk Component

Did the Investment Services Consolidation Group hold any positions in commodities during the reporting period?	

For the period from [ ] to [ ]

Dealing Profit / (Loss)

1.0 *Dealing Profit or (Loss)*

a) Dealing Profit or (Loss) - Trading	-		
b) Dealing Profit or (Loss) - Long Term Financial Instruments	-	*Total Dealing Profit or (Loss)*	-

Revenue

ISA-related:

2.0 *Commissions Received*

a) Commissions received on transactions in :				
i) locally based schemes		-		
ii) foreign based schemes				
- listed on an EU Regulated Market or the				
Regulated Market of a developed financial centre	-			
- listed in other markets	-	-		
b) Other commission (equities, debt instruments etc.)		-	*Total commissions*	-

3.0 *Investment Management and Administration Fees*

a) Retail clients	-		
b) Professional clients and eligible counterparties	-		
c) Collective Investment Schemes	-		
d) Other (e.g. Connected companies)	-	*Total investment management fees*	-

4.0 *Investment Advisory Fees*

a) Retail clients	-		
b) Professional clients and eligible counterparties	-		
c) Collective Investment Schemes	-		
d) Other (e.g. Connected companies)	-	*Total investment advisory fees*	-

5.0 *Other ISA related revenue**		-
6.0 ***Non-ISA related revenue***		-
7.0 **Total Revenue**		**-**

8.0 ** Details of 'Other ISA related revenue' and/or Any other details or comments:*

CONSOLIDATED INCOME STATEMENT & ITEMS THROUGH THE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

AFR 2

For the period from [ ] to [ ]

Expenditure

9.0 *Commissions and fees*

a) Allowable commissions and fees	-		
b) Other	-	*Total Commissions and Fees*	-

10.0 *Exceptional Items of expenditure*

a) Allowed by MFSA*	-		
b) Other	-	*Total Exceptional items*	-

11.0 *Other expenditure*

a) Depreciation	-		
b) Staff bonuses	-		
c) Employees' and directors' shares in profits	-		
d) Interest charges in respect of borrowing made to finance the acquisition of your readily realisable investments	-		
e) Interest paid to clients on clients' money	-		
f) Interest paid to counterparties	-		
g) Fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions	-		
h) Foreign exchange losses	-		
i) Directors' emoluments	-		
j) Other variable expenses *	-		
k) Other fixed expenses *	-	*Total Other expenditure*	-

12.0 **Total Expenditure** -

Other Consolidated Income Statement Items

13.0 l) Unrealised fair value movements on "Designated at inception at fair value through profit and loss account" financial instruments	-		
m) Unrealised fair value movements on "Held for trading" financial instruments	-		-

14.0 **Profit or (Loss) on Ordinary Activities before Taxation** **-**

15.0 *Taxation* -

16.0 *Other operating income/ charges net of attributable taxation* -

17.0 **Profit or (Loss) after taxation and other operating income/ charges** **-**

CONSOLIDATED INCOME STATEMENT & ITEMS THROUGH THE CONSOLIDATED STATEMENT OF CHANGES IN EQUITY

AFR 2

For the period from [ ] to [ ]

18.0 **Items effected through the Statement of changes in Equity during the reporting period**

a) Dividends	- paid	-	
	- dividends declared but not paid	-	
b) Unrealised fair value movements on "Available for sale" financial instruments		-	
c) Unrealised fair value movements on revaluation of property		-	
d) Other movements through the statement of changes in equity		-	-

19.0 **Retained Earnings for the year/ period** **-**

20.0 ** Details of 'Exceptional items of expenditure allowed by MFSA', 'Other Variable Expenditure', 'Other Fixed Expenditure' and/or any other details or comments:*

CONSOLIDATED BALANCE SHEET

AFR 3

As at

1.0	*Fixed Assets*			
	a) Intangible assets	-		
	b) Tangible assets	-	*Total Fixed Assets*	-
2.0	*Other non-current Assets*			
	a) Deferred tax	-	*Total Other non-current Assets*	-
3.0	*Current Assets*			
	a) Financial Instruments - Long Positions	-		
	b) Trading Book Debtors	-		
	c) Non-Trading Book Debtors	-		
	d) Amounts due from group companies**	-		
	e) Amounts due from other connected persons*	-		
	f) Prepayments	-		
	g) Accrued Income	-		
	h) Amounts receivable from government bodies	-		
	i) Amounts receivable from financial institutions	-		
	j) Bank and cash balances	-		
	k) Other debts	-	*Total Current Assets*	-
4.0	*Creditors : Amounts falling due within one year*			
	a) Loans/overdrafts	-		
	b) Taxation	-		
	c) Amounts due to group companies**	-		
	d) Amounts due to other connected persons*	-		
	e) Accruals	-		
	f) Financial instruments - Short Positions	-		
	g) Other creditors	-	*Total short-term creditors*	-
5.0	**Net Current Assets**			**-**
6.0	**Total Assets less Current Liabilities**			**-**
7.0	*Creditors : Amounts falling due after more than one year*			
	a) Loans: i) subordinated	-		
	ii) other	-	-	
	b) Amounts due to group companies**		-	
	c) Amounts due to other connected persons*		-	
	d) Other long term liabilities		-	*Total long-term creditors* -
8.0	*Provisions for liabilities and charges*			
	a) Deferred Tax Liability		-	
	b) Other		-	*Total prov. for liabilities/charges* -
9.0	**Total Assets less Total Liabilities**			**-**
10.0	*Capital and Reserves*			
	a) Called up ordinary share capital		-	
	b) Preference share capital		-	
	c) Investor Compensation Scheme Reserve		-	
	d) Share premium account		-	
	e) Property & financial instruments' revaluation reserves		-	
	f) Revenue reserves i) as per the previous year's audited accounts		-	
	ii) retained profits/ (loss) for the year/ period		-	
	g) Other reserves		-	*Total capital and reserves* **-**
11.0	**Minority Interest**			**-**

12.0 ** Details of 'Amounts due to/ from other connected persons' and/or **'Amounts due to/ from group Companies' and/or Any other details or comments:*

CONSOLIDATED TOTAL OWN FUNDS CALCULATION

AFR 4

As at

1.0 *Core Tier One Capital*

a) Paid-up ordinary share capital	-		
b) Share premium account	-		
c) Revenue Reserves	-		
d) Interim net profits/ retained profit for the year net of forseeable dividends	-		
e) Other Reserves	-	*Total Core Tier One Capital*	-

2.0 *Non Core Tier One Capital*

a) Perpetual Non-cumulative preference shares	-		
b) Minority Interests	-	*Total Non-Core Tier One Capital*	-

3.0 *Deductions from Tier One Capital*

a) Investments in own shares	-		
b) Goodwill	-		
c) Other Intangible assets	-		
d) Material current year losses/ retained losses for the year net of forseeable dividends	-		
e) Unrealised fair value movements on "Designated at inception at fair value through the profit and loss account" financial instruments	-	*Total Tier One Capital deductions*	-

4.0 *IFRS Prudential Filters*

a) Unrealised net losses on "Designated at inception at fair value through the profit and loss account" financial instruments	-		
b) Deductions in relation to fair value movements on "available for sale" financial instruments	-		
c) Unrealised losses on revaluation of property	-	*Total Prudential Filters*	-

5.0 **Total Tier One Capital** -

6.0 *Upper Tier Two Capital*

a) Perpetual Securities	-	*Total Upper Tier Two Capital*	-

7.0 *Lower Tier Two Capital*

a) Fixed Term Preference Share Capital (if not redeemable within 5 years)	-		
b) Bank and/ or other third party guarantees	-		
c) Subordinated Loan Capital	-		
d) IRB - calculation of risk weight exposure amounts for credit risk		*Total Own Funds Adjustments*	-

8.0 *Prudential Filters **additions** to Own Funds*

a) Unrealised gains on "Designated at inception at fair value through the profit and loss account" financial instruments	-		
b) Additions in relation to fair value movements on "available for sale" financial instruments	-		
c) Unrealised gains on revaluation of property	-	*Total Prudential Filters*	-

9.0 **Total Tier Two Capital before deductions** -

10.0 *Deductions from Tier Two Capital*

a) Material holdings in credit and financial institutions	-		
b) Expected losses from risk weighted exposure amounts using the Internal Ratings Based Approach			
c) Internal Ratings Based value adjustments			
d) Additional deductions	-		
e) Additional capital requirement	-	*Total Tier Two deductions*	-

11.0	**Total Tier Two Capital**			-
12.0	*Lower Tier Three Capital*			
	Interim Trading Book Profits/ Losses	-	*Total Lower Tier Three Capital*	-
13.0	**Total Tier Three Capital**			-
14.0	**Total Own Funds**			-

OWN FUNDS WARNINGS:

1.0	
2.0	
3.0	

1.0 Currency in which accounts have been prepared: **-**

Non-Trading Book Business Asset Exposure	*Exposure Value*	*Risk Weight*	*Risk Weighted Exposure Amount*
2.0 *Exposure - Class 1*			
Tangible assets			
a) Land & Buildings	-	100%	-
b) Other Tangible Assets	-	100%	-
3.0 *Exposure - Class 2*			
Claims or contingent claims on central governments or central banks			
	-	-	-
	-	-	-
	-	-	-
	-	-	-
	-	-	-
	-	-	-
	-	-	-
	-	-	-
4.0 *Exposure - Class 3*			
i) Debt securities issued by EEA Financial Services licensed entitites			
-	-	0%	-
-	-	0%	-
-	-	0%	-
-	-	0%	-
-	-	0%	-
-	-	0%	-
-	-	0%	-
-	-	0%	-
ii) Amounts receiveable from EEA financial services licensed entities			
a) Amounts receivable within 90 days	-	20%	-
b) Amounts receiveable after more than 90 days	-	50%	-
5.0 *Exposure - Class 4*			
i) Debt securities issued by entities other than EEA Financial Services licensed entitites			
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
-	-	-	-
6.0 *Exposure - Class 5*			
i) Units in High Risk Collective Investment Schemes			
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-

ii) Units in Other Collective Investment Schemes			
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-

7.0 *Exposure - Class 6*

i) Shares traded on a EU Regulated Market or the Regulated Market of a developed financial centre			
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
ii) Other Shares [including investments in venture capital firms and private equity investments]			
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
-	-	150%	-
iii) Investments in connected companies			
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-
-	-	100%	-

8.0 *Exposure - Class 7*

Amounts receiveable from govenrment bodies and local authorities			
a) Amounts receivable within 90 days	-	20%	-
b) Amounts receiveable after more than 90 days	-	50%	-

9.0 *Exposure - Class 8*

Other Balance Sheet Items			
i) Debtors			
a) Collective investment schemes	-	100%	-
b) Group debtors			
1) Amounts due from group companies	-	100%	-
2) Amounts due from other connected persons	-	100%	-
c) Trade debtors	-	100%	-
ii) Prepayments	-	100%	-
iii) Accrued income	-	100%	-
iv) Other debtors	-	100%	-

Total Risk Weighted Exposure Amount	-
Consolidated Credit Risk Calculation utilising the Standardised Approach	-

CONSOLIDATED POSITION RISK - TRADED DEBT INSTRUMENTS
- SPECIFIC RISK COMPONENT **AFR 6**

1.0 Currency in which accounts have been prepared: **-**

2.0 Financial instrument positions as at (date):

Description of Financial Instrument	*Investment reported in accounts in currency of Accounts*	*Investment at Market Value in currency of Accounts*	*No of months to maturity*	*Credit Quality Assessment*	*Risk Discount Factor*	*Adjusted Specific Position Risk*
3.0 ***Claims or contingent claims on central governments or central banks***						
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
4.0 ***Debt securities issued by EEA Financial Services licensed entities***						
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
5.0 ***Debt securities issued by corporates/ other entities other than EEA Financial Services licensed entities***						
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
-			-	-		
6.0 ***Instruments in any of the above categories but which face particular risk in view of insufficient solvency of the issuer of liquidity***						
-					12%	
-					12%	
-					12%	
-					12%	
-					12%	
-					12%	
-					12%	
-					12%	

Long Positions - Adjustment	-
Short Positions - Adjustment	-
Netting adjustment - (Net ONLY long and short positions in the same instrument)	
Specific Consolidated Position Risk Component	-

TRADING BOOK BUSINESS

CONSOLIDATED POSITION RISK - TRADED DEBT INSTRUMENTS
- GENERAL RISK COMPONENT **AFR 7**

1.0 Currency in which accounts have been prepared: -

2.0 Financial instrument positions as at (date):

	Description of investment (including number of shares)	*Investment reported in accounts in currency of Accounts*	*Investment at Market Value in currency of Accounts*	*No of months to maturity*	*Coupon rate*	*Risk Discount Factor*	*Weighted Long Positions*	*Weighted Short Positions*	*Maturity Band*
3.0	***Claims or contingent claims on central governments or central banks***								
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
4.0	***Debt securities issued by EEA Financial Services licensed entities***								
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			

TRADING BOOK BUSINESS

CONSOLIDATED POSITION RISK - TRADED DEBT INSTRUMENTS
- GENERAL RISK COMPONENT **AFR 7**

5.0	***Debt securities issued by entities other than EEA Financial Services licensed entities***									
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
	-				-	0.00%			
6.0	***Instruments in any of the above categories but which face particular risk in view of insufficient solvency of the issuer of liquidity***									
	-			-	-	0.00%			
	-			-	-	0.00%			
	-			-	-	0.00%			
	-			-	-	0.00%			
	-			-	-	0.00%			
	-			-	-	0.00%			
	-			-	-	0.00%			
	-			-	-	0.00%			

Match positions within zone	*Long Positions*	*Short Positions*	*Net Positions*
Zone One	-	-	-
Zone Two	-	-	-
Zone Three	-	-	-

General Consolidated Position Risk Component -

CONSOLIDATED POSITION RISK
- EQUITY RISK COMPONENT

AFR 8

1.0 Currency in which accounts have been prepared: -

2.0 Investments as at (date):

Description of investment (including number of shares)	Investment reported in accounts in currency of Accounts	Long Positions at Market Value in currency of Accounts	Short Positions at Market Value in currency of Accounts	Equity Specific Risk	Equity General Risk	Adjusted Position Risk
3.0 ***Shares traded on a EU Regulated Market or the Regulated Market of a developed financial centre***						
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
Total Overall Position		-	-			
Overall Gross Position			-	2%		-
Netting adjustment - (Net ONLY long and short positions in the same instrument)						
Overall Net Position			-		8%	-
4.0 ***Other Shares [including investments in venture capital firms and private equity investments]***						
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
-		-	-			
Total Overall Position		-	-			
Overall Gross Position			-	4%		-
Netting adjustment - (Net ONLY long and short positions in the same instrument)						
Overall Net Position			-		8%	-
Total Consolidated Equity Position Risk						-

TRADING BOOK BUSINESS

CONSOLIDATED POSITION RISK
- COLLECTIVE INVESTMENT SCHEME RISK COMPONENT **AFR 9**

1.0 Currency in which accounts have been prepared: -

2.0 Investments as at (date):

Description of investment (including number of shares)	*Investment reported in accounts in currency of Accounts*	*Investment at Market Value in currency of Accounts*	*Risk Discount Factor*	*Adjusted Position Risk*
3.0 ***Units in High Risk Collective Investment Schemes***				
		-	32%	-
		-	32%	-
		-	32%	-
		-	32%	-
		-	32%	-
		-	32%	-
		-	32%	-
		-	32%	-
4.0 ***Units in Other Collective Investment Schemes***				
		-	16%	-
		-	16%	-
		-	16%	-
		-	16%	-
		-	16%	-
		-	16%	-
		-	16%	-
		-	16%	-

Long Positions - Adjustment	-
Long Positions - Adjustment	-
Netting adjustment - (Net ONLY long and short positions in the same instrument)	
Total Consolidated Position Risk Adjustment	-

TRADING BOOK BUSINESS

CONSOLIDATED SETTLEMENT RISK COMPONENT

AFR 10

1.0 Currency in which accounts have been prepared: **-**

2.0 Investments as at (date):

Debtors Unsettled Securities Transactions - Cash against documents	*Exposure as reported in the financial statements*	*Exposure at Market Value in currency of Accounts*	*Risk Discount Factor*	*Adjusted Settlement Risk*
0 - 4 working days	-	-	0%	-
5 - 15 working days	-	-	8%	-
16 - 30 working days	-	-	50%	-
31 - 45 working days	-	-	75%	-
46 or more working days	-	-	100%	-

Total Consolidated Settlement Risk -

TRADING BOOK BUSINESS

CONSOLIDATED FREE DELIVERIES **AFR 11**

1.0 Currency in which accounts have been prepared: -

2.0 Investments as at (date):

Unsettled Securities Transations - Free Deliveries	*Exposure as reported in the financial statements*	*Exposure at Market Value in currency of Accounts*	*Risk Discount Factor*	*Adjusted Settlement Risk*
a) Where financial instruments have been delivered by the Licence Holder, qualifying as trading book business but for which payment is still due after delivery date				
1) Up to first contractual payment	-		0%	-
2) From first contractual payment to four days after second contractual payment.	-		8%	-
3) From 5 business days post contractual payment until extinction of transaction	-		100%	-
b) Where cash amounts have been settled by the Licence Holder in respect of undelivered financial instruments which qualify as trading book business.				
1) Up to first contractual delivery lag	-	-	0%	-
2) From first contractual delivery lag to four days after second contractual delivery lag.	-	-	8%	-
3) From 5 business days post contractual delivery lag until extinction of transaction	-	-	100%	-
Total Consolidated Free Deliveries				-

Large Exposures as at:

1.0 *Own funds level* -

2.0 *Report exposures to any Counterparty if the total of any* ***Trading Book*** *and* ***Non-Trading Book*** *exposures exceed 10% of own funds* -

3.0 *Large Exposures Upper Limit*

Associate Company (20% of own funds)	-
Other (25% of own funds)	-

4.0 *Aggregate Large Exposures (800% of own funds)* -

Non Trading Book Exposures

5.0

Name of individual counterparty or group of connected counterparties or its connected counterparties	Exposure in the currency of the financial statements	Proportion Exempt	Connected Company	Maximum allowable exposure	Non-exempt exposure	Amount exceeding the 25% Own Funds limit
					-	-
					-	-
					-	-
					-	-
					-	-
					-	-
					-	-
					-	-
Total Individual Non-Trading Book Exposures					-	-

Trading Book Exposures

6.0

Name of individual counterparty or group of connected counterparties or its connected counterparties	Exposure in the currency of the financial statements	Proportion Exempt	Connected Company	Maximum allowable exposure	Non-exempt exposure	Amount exceeding the 25% Own Funds limit
					-	-
					-	-
					-	-
					-	-
					-	-
					-	-
					-	-
Total Individual Trading Book Exposures					-	-

7.0 **Total Exposures exceeding the 25% Own Funds limit** -

8.0 **Aggregate Non-Exempt Exposures** -

CONSOLIDATED FOREIGN EXCHANGE RISK COMPONENT

AFR 13

Foreign Exchange Risk Component as at:

	AUD	CAD	CHF	EUR	FIM	GBP	HKD	JPY	NOK	USD	0	0
1.0 *Foreign Exchange Position*												
Assets												
a) Financial Instruments												
b) Debtors - trading book												
c) Debtors - collective investment schemes												
d) Trade Debtors												
e) Prepayments												
f) Accrued Income												
g) Amounts receivable from government bodies												
h) Amounts receivable from financial institutions												
i) Other debts												
j) Bank and Cash Balances												
k) Other Assets												
Liabilities												
a) Group creditors												
b) Accruals												
c) Other creditors												
d) Loans and overdrafts												
e) Other liabilities												
2.0 Open position in foreign Currency	-	-	-	-	-	-	-	-	-	-	-	-
3.0 Exchange rate converting the foreign currency to reporting currency												
4.0 Open position in reporting currency	-	-	-	-	-	-	-	-	-	-	-	-

5.0 Total net open position in reporting currency: -

6.0 Consolidated Foreign Exchange Risk Adjustment [Item 5.0 x 8%]: -

CONSOLIDATED FIXED OVERHEAD REQUIREMENT

AFR 14

As at

1.0	*Total Expenditure*		-
2.0	*Less:*		
	a) staff bonuses except if guaranteed;	-	
	b) employees' and directors' shares in profits, except if guaranteed	-	
	c) allowable commissions and fees	-	
	d) interest charges in respect of borrowing made to finance the acquisition of your readily realisable investments	-	
	e) interest paid to clients on clients' money	-	
	f) interest paid to counterparties	-	
	g) fees, brokerage and other charges paid to clearing houses, exchanges and intermediate brokers for the purposes of executing, registering or clearing transactions	-	
	h) foreign exchange losses	-	
	i) other variable expenditure	-	
	j) exceptional expenditure (with the **MFSA** prior approval)	-	-
3.0	*Relevant Fixed Expenditure*		-
4.0	*Pro-rated Annualised Relevant Expenditure*		-
	Consolidated Fixed Overhead Requirement		
5.0	*(One quarter of the pro-rated annualised relevant expenditure)*		-

As at

1.0	**Total Consolidated Own Funds**	-

2.0 **Non-Trading Book Business Risk Component**

a) Consolidated Credit/Counterparty Risk Component

The Credit/Counterparty risk method applied is the:

3.0 **Trading Book Business Risk Component**

a) Consolidated Position Risk	
- Traded Debt Instruments	
Specific Risk Component	-
General Risk Component	-
- Equity Position Risk	-
- Collective Investment Schemes	-
- Derivatives Risk	
b) Consolidated Settlement Risk Component - Cash against documents	-
c) Consolidated Counterparty Risk Component	
d) Consolidated Free Deliveries	-
Total Trading Book Business Risk Component	-

4.0	**Commodities Instruments - Risk Component**	
5.0	**Large Exposures Risk Component**	-
6.0	**Consolidated Foreign Exchange Risk Component**	-

7.0 **Consolidated Operational Risk Component (where applicable)**

8.0	**Total Consolidated Risk Capital Component**	-

9.0	**Consolidated Fixed Overhead Requirement**	-
10.0	**CONSOLIDATED CAPITAL RESOURCES REQUIREMENT**	-
11.0	**Consolidated Financial Resources Requirement**	-

1. Type of Investment Services Consolidation Group

The Investment Services Consolidation Group is a:

2 Members of the Investment Services Consolidation Group

(a) Parent Undertaking

Name of the Parent Undertaking	***Type of Undertaking***	***Category of Licence (where applicable)***

*(b) Subsidiary Member Undertaking/s (**Established in Malta**)*

Name of the Subsidiary Undertaking	***%age holding by the parent in the subsidiary:***	***Type of Undertaking***	***Category of Licence (where applicable)***
	%		

*(c) Subsidiary Member Undertaking/s (**Established outside Malta**)*

Name of the Subsidiary Undertaking	***%age holding by the parent in the subsidiary:***	***Type of Undertaking***	***Comparable category of licence under the Investment Services Act, 1994, in the case of a foreign investment services provider***

If there is a foreign investment services provider within the Investment Services Consolidation Group, kindly justify the choice of the comparable category of Licence Holder under the Investment Services Act, 1994 for each foreign investment services provider.

(d) Other subsidiary undertakings forming part of the Investment Services Consolidation Group which need not be included with the group for the purposes of the consolidated capital requirement

Name of the Subsidiary Undertaking	*%age holding by the parent in the subsidiary:*	*Date when MFSA granted its no objection for the exclusion of the subsidiary undertaking*

(e) Other subsidiary undertakings which are excluded from an Investment Services Consolidation Group but which form part of the same group of companies.

Name of the Subsidiary Undertaking	*%age holding by the parent in the subsidiary:*

3 Other Details

Input any other details or comments:

Insert Yes/ No:

1. Is the Investment Services Consolidation Group able, and will it be able for the forseeable future, to meet all of its liabilities as they fall due for payment?

2. Have the Investment Services Consolidation Group's Financial Resources been in excess of or equal to its Consaolidated Financial Resources Requirement throughout the period ending on the Accounting Reference Date?

3. We Confirm that :

i. The licence holder's consolidated financial resources have been properly calculated in accordance with the MFSA's requirements.

ii All matters (including contingent liabilities, claims and litigation) which might reasonably be expected to have a material effect on the licence holder's financial position at the date of submission of these statements have been declared herewith or notified in writing to MFSA.

4. This Financial Return was approved on : Date.

Signed on behalf of a Licence Holder which forms part of an Investment Services Consolidation Group:

Signed: Date:
(Director/ Authorised Signatory)

Name:

Signed: Date:
(Director/ Second Authorised Signatory)

Name:

VALIDATION SHEET

Sheet Number:		*Sheet Title*		*Description of Error*
Cover Sheet			ERROR	CHECK THAT ENTRIES IN COVER SHEET ARE CORRECTLY INPUTTED.
Sheet 1	AFR 1	INPUT SHEET - MANDATORY	OK	
Sheet 2	AFR 2	CONSOLIDATED INCOME STATEMENT	OK	
Sheet 3	AFR 3	CONSOLIDATED BALANCE SHEET	OK	
Sheet 4	AFR 4	CONSOLIDATED TOTAL OWN FUNDS CALCULATION	OK	
Sheet 5	AFR 5	NON-TRADING BOOK BUSINESS - CREDIT/COUNTERPARY RISK COMPONENT	OK	
Sheet 6	AFR 6	TRADING BOOK BUSINESS - POSITION RISK - TRADED DEBT INSTRUMENTS - SPECIFIC RISK COMPONENT	OK	
Sheet 7	AFR 7	TRADING BOOK BUSINESS - POSITION RISK - TRADED DEBT INSTRUMENTS - GENERAL RISK COMPONENT	OK	
Sheet 8	AFR 8	TRADING BOOK BUSINESS - POSITION RISK - EQUITY RISK COMPONENT	OK	
Sheet 9	AFR 9	TRADING BOOK BUSINESS - POSITION RISK - COLLECTIVE INVESTMENT SCHEME RISK COMPONENT	OK	
Sheet 10	AFR 10	TRADING BOOK BUSINESS - CONSOLIDATED SETTLEMENT	OK	

VALIDATION SHEET

Sheet Number:		*Sheet Title*		*Description of Error*
Sheet 11	AFR 11	TRADING BOOK BUSINESS - CONSOLIDATED FREE DELIVERIES	**OK**	
Sheet 12	AFR 12	LARGE EXPOSURES RISK COMPONENT	**OK**	
Sheet 13	AFR 13	CONSOLIDATED FOREIGN EXCHANGE RISK	**OK**	
Sheet 14	AFR 14	CONSOLIDATED FIXED OVERHEAD REQUIREMENT	**OK**	
Sheet 15	AFR 15	CONSOLIDATED FINANCIAL RESOURCES REQUIREMENT	**ERROR**	KINDLY INPUT THE APPROPIATE CREDIT/ COUNTERPARTY RISK COMPONENT
Sheet 16	AFR 16	FINANCIAL DETAILS INVESTMENT SERVICES CONSOLIDATION GROUP	**ERROR**	QUESTIONS 1 & 2 HAVE NOT BEEN CORRECTLY ANSWERED
Sheet 17	AFR 17	REPRESENTATIONS	**ERROR**	ENSURE THAT QUESTIONS: 1, 2 & 7 ARE COMPLETED ENSURE THAT SIGNATURES OF DIRECTORS/ AUTHORISED SIGNATORIES AND DATES ARE COMPLETED

EUROPEAN COMMISSION
Internal Market and Services DG

FINANCIAL INSTITUTIONS
Banking and financial conglomerates

CRD POTENTIAL CHANGES
Co-decision
Comitology

This document is a working document of the Commission services for discussion and consultation purposes. It does not purport to represent or pre-judge the formal proposal of the Commission.

Public consultation on possible changes to the Capital Requirements Directive (CRD, consisting of Directives 2006/48/EC and 2006/49/EC)

I. Introduction

The purpose of this working document is to consult the industry and other interested parties on potential changes to the "Capital Requirements Directive"[1] with regard to large exposures, hybrid capital instruments, supervisory arrangements, the waivers for cooperative banks organised in networks and adjustments to certain technical provisions.

The changes on which views of stakeholders are being sought, in part, reflect a response to the credit market turmoil that emerged mid-2007 and the "Roadmap" of responses agreed by the ECOFIN Council in October 2007[2], and confirmed by the European Council on 14 March 2008, while other changes reflect work that has already been underway for a number of years.

II. Procedure

The amendments would be made using two different legislative instruments:

1. An amending directive proposed by the Commission and adopted by the Council and European Parliament under the "co-decision procedure" in accordance with the EC Treaty. This directive should include amendments on: large exposures, hybrids, cooperation between supervisors and 'home/host' issues, the extension of the waivers for co-operative bank networks and some of the technical changes to the CRD annexes (those in Annex III of Directive 2006/48/EC to which the "comitology" procedure does not apply). This directive would be a "Level 1" measure under the Lamfalussy approach;

2. An implementing directive to be adopted by the Commission with the approval of the European Banking Committee ("comitology" procedure), which would incorporate certain technical changes to the annexes of the CRD. This directive would be a "Level 2" measure under the Lamfalussy approach. The adoption of this directive will comply with the inter-institutional agreement that applies to this procedure.

III. Consultation procedure

3. There are six different sections covering the following issues:

   A. Large exposures

   B. Hybrid capital instruments

   C. Supervisory arrangements

   D. Waivers for cooperative bank networks and other technical amendments

[1] also referred to as the CRD; this collectively denotes Directive 2006/48/EC of the European Parliament and of the Council of 14 June 2006 relating to the taking up and pursuit of the business of credit institutions and Directive 2006/49/EC of the European Parliament and of the Council of 14 June 2006 on the capital adequacy of investment firms and credit institutions.

[2] http://www.consilium.europa.eu/ueDocs/cms_Data/docs/pressData/en/ecofin/96375.pdf

E. Technical amendments to Directive 2006/48/EC

F. Technical amendments to Directive 2006/49/EC

4. The main target group for this consultation consists of credit institutions and investment firms and their professional associations. However, any interested stakeholder is invited to comment.

5. Responses should only be sent to the following e-mail address: markt-crd2008-survey@ec.europa.eu

6. The deadline for contributions is 16 June 2008.

7. All contributions will be published on the web site http://circa.europa.eu/Public/irc/markt/markt_consultations/library?l=/financial_services/cross-sector_issues&vm=detailed&sb=Title unless the respondent indicates that the contribution shall be treated confidentially. General confidentiality disclaimers that often appear at the bottom of emails will be disregarded unless an explicit request for confidentiality is made in the body of the response. A summary of responses will be published on the same web site at the end of June 2008.

8. The responses to this consultation will provide guidance to the Commission services for the next step i.e. the preparation of a Commission proposal that is scheduled to be adopted in September 2008.

This document is a working document of the Commission services for discussion and consultation purposes. It does not purport to represent or pre-judge the formal proposal of the Commission.

This working document includes:
Text in 'strikethrough' - this represents the current provisions in the CRD, for which amendments are being proposed;
'Underlined' text - this constitutes the proposed new text;
'Unmarked' text – text related to the above, which remains unchanged.

AMENDMENTS SUBJECT TO THE CO-DECISION PROCEDURE

A. LARGE EXPOSURES

The current CRD provisions are based on the general assumption that banks spread their exposures. However despite this, banks could still be exposed to the same client or a group of connected clients; such a concentration of risk could, in extreme situations, lead to the loss of the full exposure or of its part. To prevent against this, prudential rules currently limit such "large exposures" to a percentage of the own funds of a bank.

The existing large exposures regime in the CRD has broadly remained unchanged for 16 years and needs to be updated to take account of market developments as well as the evolution of risk management practices within institutions.

In response to the Commission services' request to the Committee of European Banking Supervisors (CEBS) for advice on the review of the large exposures, the latter consulted the industry. The final advice was published on 3 April 2008 [http://www.c-ebs.org/press/20080403_LE.htm].

Changes to Directive 2006/48/EC

Article 4, paragraphs 6 and 45

(6) 'institutions', for the purposes of Sections 2, ~~and~~ 3 and 5 of Title V, Chapter 2, means institutions as defined in Article 3(1)(c) of Directive 2006/49/EC;

(45) 'group of connected clients' means:

(a) two or more natural or legal persons who, unless it is shown otherwise, constitute a single risk because one of them, directly or indirectly, has control over the other or others; or
(b) two or more natural or legal persons between whom there is no relationship of control as set out in point (a) but who are to be regarded as constituting a single risk because they

are so interconnected that, if one of them were to experience financial problems, in particular funding or repayment difficulties, the other or all of the others would be likely to encounter funding or repayment difficulties.

Article 106

1. 'Exposures', for the purposes of this Section, shall mean any asset or off-balance-sheet item referred to in Section 3, Subsection 1, without application of the risk weights or degrees of risk there provided for.

Exposures arising from the items referred to in Annex IV shall be calculated in accordance with one of the methods set out in Annex III. For the purposes of this Section, Annex III, Part 2, point 2 shall also apply.

All elements entirely covered by own funds may, with the agreement of the competent authorities, be excluded from the determination of exposures, provided that such own funds are not included in the credit institution's own funds for the purposes of Article 75 or in the calculation of other monitoring ratios provided for in this Directive and in other Community acts.

For the purpose of this Section own funds shall mean own funds as referred to in Article 57 without deducting items referred to in Article 57(q) and accepting items referred to in Article 63(3).

2. Exposures shall not include either of the following:

(a) in the case of foreign exchange transactions, exposures incurred in the ordinary course of settlement during the 48 hours following payment; or

(b) in the case of transactions for the purchase or sale of securities, exposures incurred in the ordinary course of settlement during the five working days following payment or delivery of the securities, whichever is the earlier.

3. In respect of exposures referred to in Article 79, paragraph 1, points m, o and p, where there is an exposure to underlying assets, a credit institution shall look through to the underlying exposures where it is aware of them in order to determine the existence of a group of connected clients.

Article 107

Notwithstanding Article 4 paragraph (1), ~~F~~for the purposes of calculating the value of exposures in accordance with~~applying~~ this Section, the term 'credit institution' shall also cover ~~the following:~~

~~(a) a credit institution, including its branches in third countries; and~~

~~(b)~~ any private or public undertaking, including its branches, which meets the definition of 'credit institution' and has been authorised in a third country.

Article 108

A credit institution's exposure to a client or group of connected clients shall be considered a large exposure where its value is equal to or exceeds 10 % of its own funds.

Article 109

The competent authorities shall require that every credit institution have sound administrative and accounting procedures and adequate internal control mechanisms for the purposes of identifying and recording all large exposures and subsequent changes to them, in accordance with this Directive, and for that of monitoring those exposures in the light of each credit institution's own exposure policies.

Article 110

1. A credit institution shall report the following information about every large exposure to the competent authorities, including those exempted from the application of Article 111(1):~~.~~

a) the identification of the client or the group of connected clients to which a credit institution has a large exposure;

b) the exposure value before taking into account the effect of the credit risk mitigation, to the extent possible;

c) where used, the type of funded or unfunded credit protection;

d) the exposure value after taking into account the effect of the credit risk mitigation calculated for the purpose of Article 111(1).

If a credit institution is subject to Articles 84 to 89, its 20 largest exposures on a consolidated basis, excluding those exempted from the application of Article 111(1), shall be made available to the competent authorities.

2. Member States shall provide that reporting is to be carried out not less than twice each year.~~, at their discretion, in accordance with one of the following two methods:~~

~~(a) reporting of all large exposures at least once a year, combined with reporting during the year of all new large exposures and any increases in existing large exposures of at least 20 % with respect to the previous communication; or~~

~~(b) reporting of all large exposures at least four times a year.~~

~~2. Except in the case of credit institutions relying on Article 114 for the recognition of collateral in calculating the value of exposures for the purposes of paragraphs 1, 2 and 3 of Article 111, exposures exempted under Article 113(3)(a) to (d) and (f) to (h) need not be reported as laid down in paragraph 1 and the reporting frequency laid down in point (b) of paragraph 1 of this Article may be reduced to twice a year for the exposures referred to in Article 113(3)(e) and (i), and in Articles 115 and 116.~~

~~Where a credit institution invokes this paragraph, it shall keep a record of the grounds advanced for at least one year after the event giving rise to the dispensation, so that the competent authorities may establish whether it is justified~~.

3. Member States shall~~may~~ require credit institutions to analyse, to the extent possible, their exposures to collateral issuers and providers of unfunded credit protection for possible concentrations and where appropriate take action and~~or~~ report any significant findings to their competent authority.

Article 111

1. A credit institution may not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 112 to 117, to a client or group of connected clients the value of which exceeds 25 % of its own funds.

(i) Where that client is an institution, this value may not exceed 25% of its own funds or the amount of EUR [X] million, whichever is higher.

(ii) Where a group of connected clients includes one or more institutions, a credit institution may not incur an exposure, after taking into account the effect of the credit risk mitigation in accordance with Articles 112 to 117, to all connected institutions the value of which exceeds the difference between 25% of its own funds or the amount of EUR [X] million, whichever is higher, and the sum of exposure values to the other connected clients that are not institutions. The sum of exposure values, after taking into account the effect of the credit risk mitigation in accordance with Articles 112 to 117, to other connected clients that are not institutions may not exceed 25% of a credit institution's own funds.

Member States may impose a lower amount than EUR [X] million.

~~2. Where that client or group of connected clients is the parent undertaking or subsidiary of the credit institution and/or one or more subsidiaries of that parent undertaking, the percentage laid down in paragraph 1 shall be reduced to 20 %. Member States may, however, exempt the exposures incurred to such clients from the 20 % limit if they provide for specific monitoring of such exposures by other measures or procedures. They shall inform the Commission and the European Banking Committee of the content of such measures or procedures.~~

~~3. A credit institution may not incur large exposures which in total exceed 800 % of its own funds.~~

2~~4~~. A credit institution shall at all times comply with the limit~~s~~ laid down in paragraph~~s~~ 1~~,~~ ~~2 and 3 in respect of its exposures~~. If in an exceptional case exposures exceed thi~~s~~o~~se~~ limit~~s~~, th~~e~~at ~~fact~~ value of the exposure shall be reported without delay to the competent authorities which may, where the circumstances warrant it, allow the credit institution a limited period of time in which to comply with the limit~~s~~.

Article 112

1. For the purposes of Articles 113 to 117, the term 'guarantee' shall include credit derivatives recognised under Articles 90 to 93 other than credit linked notes.

2. Subject to paragraph 3, where, under Articles 113 to 117, the recognition of funded or unfunded credit protection is~~may be~~ permitted, this shall be subject to compliance with the eligibility requirements and other minimum requirements, set out under Articles 90 to 93 ~~for the purposes of calculating risk-weighted exposure amounts under Articles 78 to 83~~.

3. Where a credit institution relies upon Article 114(2), the recognition of funded credit protection shall be subject to the relevant requirements under Articles 84 to 89.

4. For the purpose of this Section, a credit institution shall not take account of the collateral referred to in Annex VIII, Part 1, points 20-22, unless permitted under Article 115.

Article 113

~~1. Member States may impose limits more stringent than those laid down in Article 111.~~

~~2. Member States may fully or partially exempt from the application of Article 111(1), (2) and (3) exposures incurred by a credit institution to its parent undertaking, to other subsidiaries of that parent undertaking or to its own subsidiaries, in so far as those undertakings are covered by the supervision on a consolidated basis to which the credit institution itself is subject, in accordance with this Directive or with equivalent standards in force in a third country.~~

1~~3~~. ~~Member States may fully or partially exempt t~~The following exposures shall be exempted from the application of Article 111(1):

(a) asset items constituting claims on central governments or central banks which, unsecured, would be assigned a 0 % risk weight under Articles 78 to 83;

(b) asset items constituting claims on international organisations or multilateral development banks which, unsecured, would be assigned a 0 % risk weight under Articles 78 to 83;

(c) asset items constituting claims carrying the explicit guarantees of central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity providing the guarantee would be assigned a 0 % risk weight under Articles 78 to 83;

(d) other exposures attributable to, or guaranteed by, central governments, central banks, international organisations, multilateral development banks or public sector entities, where unsecured claims on the entity to which the exposure is attributable or by which it is guaranteed would be assigned a 0 % risk weight under Articles 78 to 83;

(e)~~ asset items constituting claims on and other exposures to central governments or central banks not mentioned in point (a) which are denominated and, where applicable, funded in the national currencies of the borrowers;~~ asset items constituting claims on Member States' regional governments and local authorities where those claims would be assigned a 0 % risk weight under Article 78 to 83 and to other exposures to or guaranteed by such governments and authorities claims on which would be assigned a 0 % risk weight under Articles 78 to 83;

(f)~~ asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of debt securities issued by central governments or central banks, international organisations, multilateral development banks, Member States' regional governments, local authorities or public sector entities, which securities constitute claims on their issuer which would be assigned a 0 % risk weighting under Articles 78 to 83~~ exposures to counterparties referred to in Article 80(7) or 80(8). For this purpose, point (d) of Article 80(7) shall not be applied. Exposures that do not meet these criteria, whether exempted from Article 111(1) or not, shall be treated as exposures to a third party;

(g) asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of cash deposits placed with the lending credit institution or with a credit institution which is the parent undertaking or a subsidiary of the lending institution; and

(h) asset items and other exposures secured, to the satisfaction of the competent authorities, by collateral in the form of certificates of deposit issued by the lending credit institution or by a credit institution which is the parent undertaking or a subsidiary of the lending credit institution and lodged with either of them~~;~~.

(i) asset items constituting claims on and other exposures to institutions, with a maturity of one year or less, but not constituting such institutions" own funds;

(j) asset items constituting claims on and other exposures to those institutions which are not credit institutions but which fulfil the conditions referred to in Annex VI, Part 1, point 85, with a maturity of one year or less, and secured in accordance with the same point;

(k) bills of trade and other similar bills, with a maturity of one year or less, bearing the signatures of other credit institutions;

(l) covered bonds falling within the terms of Annex VI, Part 1, points 68 to 70;

(m) pending subsequent coordination, holdings in the insurance companies referred to in Article 122(1) up to 40 % of the own funds of the credit institution acquiring such a holding;

(n) asset items constituting claims on regional or central credit institutions with which the lending credit institution is associated in a network in accordance with legal or statutory provisions and which are responsible, under those provisions, for cash clearing operations within the network;

(o) exposures secured, to the satisfaction of the competent authorities, by collateral in the form of securities other than those referred to in point (f);

(p) loans secured, to the satisfaction of the competent authorities, by mortgages on residential property or by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation and leasing transactions under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase, in all cases up to 50 % of the value of the residential property concerned;

(q) the following, where they would receive a 50 % risk weight under Articles 78 to 83, and only up to 50 % of the value of the property concerned:

(i) exposures secured by mortgages on offices or other commercial premises, or by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises; and

(ii) exposures related to property leasing transactions concerning offices or other commercial premises;

for the purposes of point (ii), until 31 December 2011, the competent authorities of each Member State may allow credit institutions to recognise 100 % of the value of the property concerned. At the end of this period, this treatment shall be reviewed. Member States shall inform the Commission of the use they make of this preferential treatment;

(r) 50 % of the medium/low-risk off-balance-sheet items referred to in Annex II;

(s) subject to the competent authorities' agreement, guarantees other than loan guarantees which have a legal or regulatory basis and are given for their members by mutual guarantee schemes possessing the status of credit institutions, subject to a weighting of 20 % of their amount; and

(t) the low risk off-balance sheet items referred to in Annex II, to the extent that an agreement has been concluded with the client or group of connected clients under which

~~the exposure may be incurred only if it has been ascertained that it will not cause the limits applicable under Article 111(1) to (3) to be exceeded.~~

Cash received under a credit linked note issued by the credit institution and loans and deposits of a counterparty to or with the credit institution which are subject to an on-balance sheet netting agreement recognised under Articles 90 to 93 shall be deemed to fall under point (g).

~~For the purposes of point (o), the securities used as collateral shall be valued at market price, have a value that exceeds the exposures guaranteed and be either traded on a stock exchange or effectively negotiable and regularly quoted on a market operated under the auspices of recognised professional operators and allowing, to the satisfaction of the competent authorities of the Member State of origin of the credit institution, for the establishment of an objective price such that the excess value of the securities may be verified at any time. The excess value required shall be 100 %. It shall, however, be 150 % in the case of shares and 50 % in the case of debt securities issued by institutions, Member State regional governments or local authorities other than those referred to in sub-point (f), and in the case of debt securities issued by multilateral development banks other than those assigned a 0 % risk weight under Articles 78 to 83. Where there is a mismatch between the maturity of the exposure and the maturity of the credit protection, the collateral shall not be recognised. Securities used as collateral may not constitute credit institutions' own funds.~~

~~For the purposes of point (p), the value of the property shall be calculated, to the satisfaction of the competent authorities, on the basis of strict valuation standards laid down by law, regulation or administrative provisions. Valuation shall be carried out at least once a year. For the purposes of point (p), residential property shall mean a residence to be occupied or let by the borrower.~~

~~Member States shall inform the Commission of any exemption granted under point (s) in order to ensure that it does not result in a distortion of competition.~~

2. Member States may fully or partially exempt covered bonds falling within the terms of Annex VI, Part 1, points 68 to 70 from the application of Article 111(1).

Article 114

1. Subject to paragraph 3, for the purposes of calculating the value of exposures for the purposes of Article 111(1) ~~to (3) Member States may, in respect of credit institutions using the Financial Collateral Comprehensive Method under Articles 90 to 93, in the alternative to availing of the full or partial exemptions permitted under points (f), (g), (h), and (o) of Article 113(3), permit such credit institutions to use a value lower than the value of the exposure, but no lower than the total of the fully-adjusted exposure values of their exposures to the client or group of connected clients. For these purposes,~~ a credit institution may use the 'fully adjusted exposure value' ~~means that~~ as calculated under Articles 90 to 93 taking into account the credit risk mitigation, volatility adjustments, and any maturity mismatch (E*).

~~Where this paragraph is applied to a credit institution, points (f), (g), (h), and (o) of Article 113(3) shall not apply to the credit institution in question.~~

2. Subject to paragraph 3, a credit institution permitted to use own estimates of LGDs and conversion factors for an exposure class under Articles 84 to 89 shall~~may~~ be

permitted, where it is able to the satisfaction of the competent authorities to estimate the effects of financial collateral on their exposures separately from other LGD-relevant aspects, to recognise such effects in calculating the value of exposures for the purposes of Article 111(1) ~~to (3)~~.

Competent authorities shall be satisfied as to the suitability of the estimates produced by the credit institution for use for the reduction of the exposure value for the purposes of compliance with the provisions of Article 111.

Where a credit institution is permitted to use its own estimates of the effects of financial collateral, it shall do so on a basis consistent with the approach adopted in the calculation of capital requirements.

Credit institutions permitted to use own estimates of LGDs and conversion factors for an exposure class under Articles 84 to 89 which do not calculate the value of their exposures using the method referred to in the first subparagraph shall~~may~~ be permitted to use the Financial Collateral Comprehensive Method or the approach set out in ~~paragraph 1 or the exemption set out in~~ Article 117(b)~~3(3)(o)~~ for calculating the value of exposures. ~~A credit institution shall use only one of these two methods.~~

3. A credit institution that makes use of the Financial Collateral Comprehensive Method or is permitted to use the method~~s~~ described in paragraph~~s 1 and~~ 2 in calculating the value of exposures for the purposes of Article 111(1) ~~to (3)~~, shall conduct periodic stress tests of their credit-risk concentrations, including in relation to the realisable value of any collateral taken.

These periodic stress tests shall address risks arising from potential changes in market conditions that could adversely impact the credit institutions' adequacy of own funds and risks arising from the realisation of collateral in stressed situations.

The credit institution shall satisfy the competent authorities that the stress tests carried out are adequate and appropriate for the assessment of such risks.

In the event that such a stress test indicates a lower realisable value of collateral taken than would be permitted to be taken into account while making use of the Financial Collateral Comprehensive Method or the method described in ~~under~~ paragraph~~s 1 and~~ 2 as appropriate, the value of collateral permitted to be recognised in calculating the value of exposures for the purposes of Article 111(1) ~~to (3)~~ shall be reduced accordingly.

Such credit institutions shall include the following in their strategies to address concentration risk:

(a) policies and procedures to address risks arising from maturity mismatches between exposures and any credit protection on those exposures;

(b) policies and procedures in the event that a stress test indicates a lower realisable value of collateral than taken into account while making use of the Financial Collateral Comprehensive Method or the method described in ~~under~~ paragraph~~s 1 and~~ 2; and

(c) policies and procedures relating to concentration risk arising from the application of credit risk mitigation techniques, and in particular large indirect credit exposures, for example to a single issuer of securities taken as collateral.

~~4. Where the effects of collateral are recognised under the terms of paragraphs 1 or 2, Member States may treat any covered Part of the exposure as having been incurred to the collateral issuer rather than to the client.~~

Article 115

1. ~~For the purposes of Article 111(1) to (3), Member States may assign a weighting of 20 % to asset items constituting claims on Member States' regional governments and local authorities where those claims would be assigned a 20 % risk weight under Articles 78 to 83 and to other exposures to or guaranteed by such governments and authorities claims on which are assigned a 20 % risk weight under Articles 78 to 83. However, Member States may reduce that rate to 0 % in respect of asset items constituting claims on Member States' regional governments and local authorities where those claims would be assigned a 0 % risk weight under Article 78 to 83 and to other exposures to or guaranteed by such governments and authorities claims on which are assigned a 0 % risk weight under Articles 78 to 83.~~

For the purpose of this section, a credit institution may reduce the exposure value by up to [50%] of the value of the residential property concerned, either:

- if the exposure is secured, to the satisfaction of the competent authorities, by mortgages on residential property or by shares in Finnish residential housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, or

- if the exposure relates to a leasing transaction under which the lessor retains full ownership of the residential property leased for as long as the lessee has not exercised his option to purchase.

For the purposes of the above, the value of the property shall be calculated, to the satisfaction of the competent authorities, on the basis of strict valuation standards laid down by law, regulation or administrative provisions. Valuation shall be carried out at least once a year. For the purposes of this paragraph, residential property shall mean a residence to be occupied or let by the borrower.

2. ~~For the purposes of Article 111(1) to (3), Member States may assign a weighting of 20 % to asset items constituting claims on and other exposures to institutions with a maturity of more than one but not more than three years and a weighting of 50 % to asset items constituting claims on institutions with a maturity of more than three years, provided that the latter are represented by debt instruments that were issued by a institution and that those debt instruments are, in the opinion of the competent authorities, effectively negotiable on a market made up of professional operators and are subject to daily quotation on that market, or the issue of which was authorised by the competent authorities of the Member State of origin of the issuing institutions. In no case may any of these items constitute own funds.~~

For the purpose of this section, a credit institution may reduce the exposure value by up to [50%] of the value of the commercial property concerned, only if the following exposures would receive a 50% risk weight under Articles 78 to 83:

(i) exposures secured by mortgages on offices or other commercial premises, or by shares in Finnish housing companies, operating in accordance with the Finnish Housing Company Act of 1991 or subsequent equivalent legislation, in respect of offices or other commercial premises or

(ii) exposures related to property leasing transactions concerning offices or other commercial premises.

For the purpose of the above, commercial property shall be fully constructed.

Article 116

~~By way of derogation from Article 113(3)(i) and Article 115(2), Member States may assign a weighting of 20 % to asset items constituting claims on and other exposures to institutions, regardless of their maturity.~~

Article 117

1. Where an exposure to a client is guaranteed by a third party, or secured by collateral ~~in the form of securities~~ issued by a third party ~~under the conditions laid down in Article 113(3)(o)~~, a credit institution~~Member States~~ may:

(a) treat the portions of the exposure which is guaranteed as having been incurred to the guarantor rather than to the client provided that the unsecured exposure to the guarantor would be assigned an equal or lower risk weight than a risk weight of the unsecured exposure to the client under Articles 78 to 83; or

(b) treat the portions of the exposure collateralised by the market value of recognised collateral as having been incurred to the third party rather than to the client, if the exposure ~~defined in Article 113(3)(o)~~ is secured~~guaranteed~~ by collateral and provided that the collateralised portion of the exposure would be assigned an equal or lower risk weight than a risk weight of the unsecured exposure to the client under Articles 78 to 83 ~~under the conditions there laid down~~. This approach shall not be used by a credit institution where there is a mismatch between the maturity of the exposure and the maturity of the protection.

For the purpose of this Section, a credit institution may use both the Financial Collateral Comprehensive Method and the treatment provided for in point (b) of paragraph 1 only where it is permitted to use both the Financial Collateral Comprehensive Method and the Financial Collateral Simple Method for the purposes of Article 75(a).

2. Where a credit institution~~Member States~~ applies~~y~~ the treatment provided for in point (a) of paragraph 1:

(a) where the guarantee is denominated in a currency different from that in which the exposure is denominated the amount of the exposure deemed to be covered will be calculated in accordance with the provisions on the treatment of currency mismatch for unfunded credit protection in Annex VIII;

(b) a mismatch between the maturity of the exposure and the maturity of the protection will be treated in accordance with the provisions on the treatment of maturity mismatch in Annex VIII; and

(c) partial coverage may be recognised in accordance with the treatment set out in Annex VIII.

Article 118

Where compliance by a credit institution on an individual or sub-consolidated basis with the obligations imposed in this Section is disapplied under Article 69(1), or the provisions of Article 70 are applied in the case of parent credit institutions in a Member State, measures must be taken to ensure the satisfactory allocation of risks within the group.

Article 119

~~By 31 December 2007, the Commission shall submit to the European Parliament and to the Council a report on the functioning of this Section, together with any appropriate proposals.~~

Changes to Directive 2006/49/EC

Article 28

1. Institutions, except investment firms that fulfil the criteria set out in Article 20(2) and 20(3), shall monitor and control their large exposures in accordance with Articles 106 to 118 of Directive 2006/48/EC.

2. By way of derogation from paragraph 1, institutions which calculate the capital requirements for their trading-book business in accordance with Annexes I and II, and, as appropriate, Annex V to this Directive, shall monitor and control their large exposures in accordance with Articles 106 to 118 of Directive 2006/48/EC subject to the amendments laid down in Articles 29 to 32 of this Directive.

~~3. By 31 December 2007, the Commission shall submit to the European Parliament and to the Council a report on the functioning of this Section, together with any appropriate proposals.~~

Article 29

1. The exposures to individual clients which arise on the trading book shall be calculated by summing the following items:

(a) the excess — where positive — of an institution's long positions over its short positions in all the financial instruments issued by the client in question, the net position in each of the different instruments being calculated according to the methods laid down in Annex I;

(b) the net exposure, in the case of the underwriting of a debt or an equity instrument; and

(c) the exposures due to the transactions, agreements and contracts referred to in Annex II with the client in question, such exposures being calculated in the manner laid down in that Annex, for the calculation of exposure values.

For the purposes of point (b), the net exposure is calculated by deducting those underwriting positions which are subscribed or sub-underwritten by third parties on the basis of a formal agreement reduced by the factors set out in point 41 of Annex I.

For the purposes of point (b), pending further coordination, the competent authorities shall require institutions to set up systems to monitor and control their underwriting exposures between the time of the initial commitment and working day one in the light of the nature of the risks incurred in the markets in question.

For the purposes of point (c), Articles 84 to 89 of Directive 2006/48/EC shall be excluded from the reference in point 6 of Annex II to this Directive.

2. The exposures to groups of connected clients on the trading book shall be calculated by summing the exposures to individual clients in a group, as calculated in paragraph 1.

Article 30

1. The overall exposures to individual clients or groups of connected clients shall be calculated by summing the exposures which arise on the trading book and the exposures which arise on the non-trading book, taking into account Article 112 to 117 of Directive 2006/48/EC.

In order to calculate the exposure which arises on the non-trading book, institutions shall take the exposure arising from assets which are deducted from their own funds by virtue of point (d) of the second subparagraph of Article 13(2) to be zero.

2. Institutions' overall exposures to individual clients and groups of connected clients calculated in accordance with paragraph 4 shall be reported in accordance with Article 110 of Directive 2006/48/EC.

Other than in relation to repurchase transactions, securities or commodities lending or borrowing transactions, the calculation of large exposures to individual clients and groups of connected clients for reporting purposes shall not include the recognition of credit risk mitigation.

3. The sum of the exposures to an individual client or group of connected clients in paragraph 1 shall be limited in accordance with Articles 111 to 117 of Directive 2006/48/EC.

4. By derogation from paragraph 3 competent authorities may allow assets constituting claims and other exposures on recognised third-country investment firms and recognised clearing houses and exchanges in financial instruments to be subject to the same treatment accorded to those on institutions laid out in Article~~s~~ 111~~3~~(1~~3~~)~~(i), 115(2) and 116~~ of Directive 2006/48/EC.

Article 31

The competent authorities may authorise the limits laid down in Articles 111 to 117 of Directive 2006/48/EC to be exceeded if the following conditions are met:

(a) the exposure on the non-trading book to the client or group of clients in question does not exceed the limit~~s~~ laid down in Article~~s~~ 111(1) ~~and (2) to 117~~ of Directive 2006/48/EC, ~~those limits~~ this limit being calculated with reference to own funds as specified in that Directive, so that the excess arises entirely on the trading book;

(b) the institution meets an additional capital requirement on the excess in respect of the limit~~s~~ laid down in Article 111(1) ~~and (2)~~ of Directive 2006/48/EC, that additional capital requirement being calculated in accordance with Annex VI to ~~that~~ Directive 2006/49/EC;

(c) where 10 days or less has elapsed since the excess occurred, the trading-book exposure to the client or group of connected clients in question shall not exceed 500 % of the institution's own funds;

(d) any excesses that have persisted for more than 10 days must not, in aggregate, exceed 600 % of the institution's own funds; and

(e) institutions shall report to the competent authorities every three months all cases where the limit~~s~~ laid down in Article 111(1) ~~and (2)~~ of Directive 2006/48/EC ~~have~~has been exceeded during the preceding three months.

In relation to point (e), in each case in which the ~~limits have~~ limit has been exceeded the amount of the excess and the name of the client concerned shall be reported.

Article 32

1. The competent authorities shall establish procedures to prevent institutions from deliberately avoiding the additional capital requirements that they would otherwise incur, on exposures exceeding the limit~~s~~ laid down in Article 111(1) ~~and (2)~~ of Directive 2006/48/EC once those exposures have been maintained for more than 10 days, by means of temporarily transferring the exposures in question to another company, whether within the same group or not, and/or by undertaking artificial transactions to close out the exposure during the 10-day period and create a new exposure.

The competent authorities shall notify the Council and the Commission of those procedures. Institutions shall maintain systems which ensure that any transfer which has the effect referred to in the first subparagraph is immediately reported to the competent authorities.

2. The competent authorities may permit institutions which are allowed to use the alternative determination of own funds under Article 13(2) to use that determination for the purposes of Articles 30(2), 30(3) and 31 provided that the institutions concerned are required to meet all of the obligations set out in Articles 110 to 117 of Directive 2006/48/EC, in respect of the exposures which arise outside their trading books by using own funds as defined in that Directive.

The Commission services are interested in learning stakeholders' views on the impact, if any, of the approach suggested above.

With regard to interbank exposures, a limit is suggested that represents the higher of 25% of a bank's own funds or Euro"X" million (the Committee of European Banking Supervisors has suggested that 'X' should be set at Euro 150 million). Stakeholders' views are sought on the appropriateness of a Euro 150 million limit for exposures to institutions, and on the impact of this suggestion for banks' funding requirements on a day-to-day basis as well as during a contingency.

B. HYBRID CAPITAL INSTRUMENTS

The Commission intends to transpose the 1998 Basel agreement on hybrid capital instruments (the so-called "Sydney Press Release"- ttp://www.bis.org/press/p981027.htm) into EU legislation.

The lack of rules at EU level has resulted in wide dispersion in the treatment of hybrid capital instruments at national level. This divergence relates to both:

- the eligibility criteria which hybrid instruments should comply with in order to qualify as own funds for prudential purposes and
- the quantitative limits for acceptance as firms' original own funds.

The Commission's proposal aims at addressing this divergence by:

(i) providing a common interpretation of the three main eligibility criteria: permanence, loss absorption and flexibility in payments;

(ii) establishing harmonised quantitative limits for the extent to which hybrids may be accepted as firms' original own funds;

(iii) allowing a grandfathering clause to avoid disruption in the financial markets with regard to instruments already issued and provide for an adequate transitional period for both firms and competent authorities.

In response to the Commission services' request to the Committee of European Banking Supervisors (CEBS) for advice on Tier 1 Hybrids, the latter consulted the industry. The final advice was published on 3 April 2008 [http://www.c-ebs.org/press/20080403.hybrids.htm].

Changes to Directive 2006/48/EC

Article 57, points (a) to (d)

Subject to the limits imposed in Article 66, the unconsolidated own funds of credit institutions shall consist of the following items:

(a) capital within the meaning of Article 22 of Directive 86/635/EEC, in so far as it has been paid up, plus the related share premium accounts, it fully absorbs losses in going concern situations, and in the event of the bankruptcy or liquidation of the credit institution, it ranks after all other claims but excluding cumulative preferential shares;

(b) reserves within the meaning of Article 23 of Directive 86/635/EEC and profits and losses brought forward as a result of the application of the final profit or loss;

(c) funds for general banking risks within the meaning of Article 38 of Directive 86/635/EEC;

(ca) "instruments other than those referred to in point (a), which meet the requirements set out in Articles 63a and in points (a) and (c) to (e) of 63 paragraph (2)";

(d) revaluation reserves within the meaning of Article 33 of Directive 78/660/EEC;

Article 61

The concept of own funds as defined in points (a) to (h) of Article 57 embodies a maximum number of items and amounts. The use of those items, ~~and the fixing of lower ceilings,~~ and the deduction of items other than those listed in points (i) to (r) of Article 57 shall be left to the discretion of the Member States.

The items listed in points (a) to (e) of Article 57 shall be available to a credit institution for unrestricted and immediate use to cover risks or losses as soon as these occur. The amount shall be net of any foreseeable tax charge at the moment of its calculation or be suitably adjusted in so far as such tax charges reduce the amount up to which these items may be applied to cover risks or losses.

Article 63a

Instruments referred to in point (ca) of Article 57 shall comply with the following criteria in addition to the criteria set out in points (a) and (c) to (e) of Article 63(2):

(a) The instrument shall be undated [or have a maturity of at least [30] years]. It may include a call option at the sole discretion of the issuer, but it shall not be redeemed before five years after the issue date.

If the statutory or contractual provisions governing undated instruments provide for a moderate incentive for the credit institution to redeem as determined by the competent authorities, such incentive shall not occur before ten years after the issue date.

[Dated and undated] instruments may be called or redeemed only with the prior consent of the competent authorities. The competent authorities may grant permission provided the request is made at the initiative of the credit institution and either financial or solvency conditions of the credit institution are not affected. The competent authorities may require institutions to replace the instrument by items referred to in points (a) or items of the same or better quality referred to in point (ca) of Article 57."

[The competent authorities shall require the suspension of the redemption for dated instruments if the credit institution does not comply with the capital requirements set out in Article 75].

The competent authority may grant permission for an early redemption of dated and undated instruments in the event that there is a change in national tax treatment or regulatory classification which was unforeseen at the issuance date."

(b) The statutory or contractual provisions governing the instrument shall allow the credit institution to cancel, when necessary, the payment of interest and dividends for an unlimited period of time, on a non-cumulative basis. Notwithstanding the above, the credit institution shall be obliged to cancel such payments if it does not comply with the capital requirements set out in Article 75. The competent authorities may require the cancellation of such payments based on the financial and solvency situation of the credit institution. Such cancellation shall not prejudice the right of the credit institution to substitute the payment of interest or dividend by a payment in the form of an instrument referred to in Article 57 point (a), provided that any such mechanism allows the credit

institution to preserve financial resources. Such substitution may be subject to specific conditions required by the competent authorities.

(c) The statutory or contractual provisions governing the instrument shall provide for principal, unpaid interest and dividend to be such as to absorb losses and to not hinder the recapitalisation of the credit institution.

(d) In the event of the bankruptcy or liquidation of the credit institution, the instrument shall rank after the items referred to in Article 63 (2)."

Article 65, paragraph 1

1. Where the calculation is to be made on a consolidated basis, the consolidated amounts relating to the items listed under Article 57 shall be used in accordance with the rules laid down in Chapter 4, Section 1. Moreover, the following may, when they are credit ('negative') items, be regarded as consolidated reserves for the calculation of own funds:

(a) Any minority interests within the meaning of Article 21 of Directive 83/349/EEC, where the global integration method is used~~;~~. Any instruments referred to in point (ca) of Article 57, which give rise to minority interests shall meet the requirements under Articles 63a, 66, and points (a) and (c) to (e) of Article 63(2);

(b) the first consolidation difference within the meaning of Articles 19, 30 and 31 of Directive 83/349/EEC;

(c) the translation differences included in consolidated reserves in accordance with Article 39(6) of Directive 86/635/EEC;

(d) any difference resulting from the inclusion of certain participating interests in accordance with the method prescribed in Article 33 of Directive 83/349/EEC.

Article 66

1. The items referred to in points (d) to (h) of Article 57 shall be subject to the following limits:

(a) the total of the items in points (d) to (h) may not exceed a maximum of 100 % of the items in points (a) ~~plus (b) and (c)~~ to (ca) minus (i) to (k); and

(b) the total of the items in points (g) to (h) may not exceed a maximum of 50 % of the items in points (a) ~~plus (b) and (c)~~ to (ca) minus (i) to (k).

1a. Without prejudice to the first paragraph, the total of the items in point (ca) of Article 57 shall be subject to the following limits:

(a) Instruments that will be converted during emergency situations into a pre-determined fixed number of items referred to in point (a) of Article 57 shall not exceed a maximum of 50% of the items in points (a) to (ca) minus (i) to (k) of Article 57;

(b) Within the limit referred to in point (a) above, all other instruments shall not exceed a maximum of 35% of the items in points (a) to (ca) minus (i) to (k) of Article 57;

(c) Within the limit referred to in points (a) and (b) above, dated instruments and any instrument, whose statutory or contractual provisions provide for an incentive for the credit institution to redeem shall not exceed a maximum of 15% of the items in points (a) to (ca) minus (i) to (k) of Article 57.

(d) The amount of items exceeding the limits set out in points (a) to (c) is subject to the limit set out in paragraph 1.

2. The total of the items in points (l) to (r) of Article 57 shall be deducted half from the total of the items (a) to ~~(c)~~(ca) minus (i) to (k), and half from the total of the items (d) to (h) of Article 57, after application of the limits laid down in paragraph 1 of this Article. To the extent that half of the total of the items (l) to (r) exceeds the total of the items (d) to (h) of Article 57, the excess shall be deducted from the total of the items (a) to ~~(c)~~(ca) minus (i) to (k) of Article 57. Items in point (r) of Article 57 shall not be deducted if they have been included in the calculation of risk-weighted exposure amounts for the purposes of Article 75 as specified in Annex IX, Part 4.

3. For the purposes of Sections 5 and 6, the provisions laid down in this Section shall be read without taking into account the items referred to in points (q) and (r) of Article 57 and Article 63(3).

4. The competent authorities may authorise credit institutions to exceed the limits laid down in paragraphs 1 and 1a temporarily during emergency situations ~~in temporary and exceptional circumstances~~."

Article 154, paragraphs 7-9

7. Until 31 December 2011, for corporate exposures, the competent authorities of each Member State may set the number of days past due that all credit institutions in its jurisdiction shall abide by under the definition of 'default' set out in Annex VII, Part 4, point 44 for exposures to such counterparts situated within this Member State. The specific number shall fall within 90- up to a figure of 180 days if local conditions make it appropriate. For exposures to such counterparts situated in the territories of other Member States, the competent authorities shall set a number of days past due which is not higher than the number set by the competent authority of the respective Member State.

8. credit institutions which do not comply [at the date of entry into force] with the limits set out in Article 66 paragraph 1a will agree with their competent authorities on the necessary measures to resolve this situation before the dates indicated in point 9 below.

9. Instruments that, as of [the date of entry into force], according to national law were deemed equivalent to the items referred to in points (a) to (c) of Article 57 but do not fall within point (a) of Article 57 or do not comply with the criteria set out in Article 63a, shall be deemed to fall within point (ca) of Article 57 until [the date of entry into force+30years], if they do not represent an amount higher than:

(a) 20% of the sum of points (a) to (ca) of Article 57, less the sum of points (i) to (k) of Article 57 between [the date of entry into force +10 years] and [the date of entry into force+20years];

(b) 10% of the sum of points (a) to (ca) of Article 57, less the sum of points (i) to (k) of Article 57 between [the date of entry into force+20years] and [the date of entry into force+30years].

Technical criteria on disclosure
Annex XII, part 2, points 3 (a) and (b)

(a) summary information on the terms and conditions of the main features of all own funds items and components thereof, including instruments referred to in point (ca) of Article 57, instruments the statutory or contractual provisions of which provide an incentive for the credit institution to redeem them, and instruments subject to Article 154 paragraphs (8);

(b) the amount of the original own funds, with separate disclosure of all positive items and deductions. The overall amount of instruments referred to in point (ca) of Article 57 and instruments the statutory or contractual provisions of which provide an incentive for the credit institution to redeem them, shall also be disclosed separately. These disclosures shall each specify instruments subject to Article 154 paragraphs (8);"

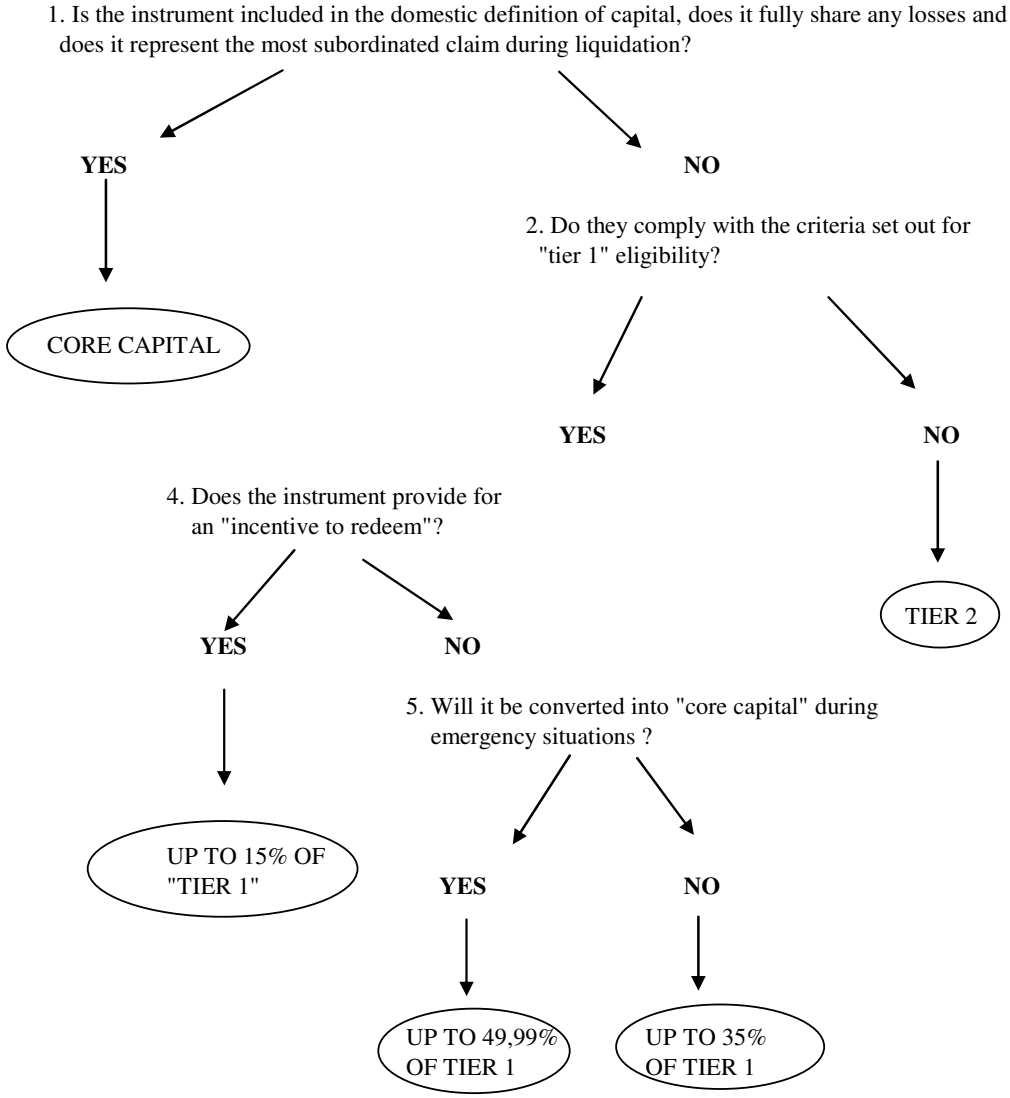
Changes to Directive 2006/49

Article 12, subparagraph 1

'Original own funds' means the sum of points (a) to ~~(c)~~(ca), less the sum of points (i) to (k) of Article 57 of Directive 2006/48/EC, provided that they comply with limits set out in Article 66 of the same Directive.

The following chart depicts the assessment process by which an instrument may be assessed to determine its eligibility as well as to establish the quantitative limits to its recognition as Tier 1 capital.

DECISION CHART



Do stakeholders agree with:

(i) the Commission services' suggested eligibility criteria and the principle-based approach suggested above?

(ii) the recognition of dated instruments - with a predetermined minimum original maturity - in firms' original own funds?

(iii) the quantitative limits suggested? In this respect, the Commission services are also interested in views whether an additional limit would be useful to improve even further the quality of capital e.g. by requiring firms' core capital (equity, reserves and retained earnings) to be higher than a pre-determined proportion (e.g. 50%) of minimum capital requirements?

C. SUPERVISORY ARRANGEMENTS

It is the Commission's intent to improve cooperation and information exchange in the field of crisis management and home/host issues. As a consequence of the work of the European Financial Committee's Working Group on Crisis Management and the endorsement of its recommendations by ECOFIN on 9th October, the potential amendments relate to:

- improving information rights of host supervisors of systemically relevant branches;
- reinforcing supervisory cooperation and clarifying supervisors' tasks and responsibilities;
- requiring supervisors to have regard to financial stability concerns in all Member States concerned and
- clarifying the legal framework for transmitting information to ministries of finance and central banks.

While not modifying the allocation of responsibilities between the home and the host supervisors, the suggested amendments will reinforce the efficiency and effectiveness of supervision of cross-border banking groups by requiring i) the establishment of colleges of supervisors, ii) agreement within colleges on key home/host issues e.g. capital add-on on subsidiaries, reporting requirements and iii) referrals to CEBS in case of disagreement within colleges. Colleges will also be required for supervisors overseeing cross-border structures that do not have subsidiaries in other Member States but that do have systemically important branches.

Changes to Directive 2006/48/EC

Article 4, paragraphs 48 and 49

(48) 'Systemically relevant branch" means a branch of a credit institution that has been designated as such by the competent authorities under Article 42(2).

(49) 'consolidating supervisor' means the competent authority responsible for the exercise of supervision on a consolidated basis of EU parent credit institutions and credit institutions controlled by EU parent financial holding companies.

Article 40

1. The prudential supervision of a credit institution, including that of the activities it carries on accordance with Articles 23 and 24, shall be the responsibility of the competent authorities of the home Member State, without prejudice to those provisions of this Directive which give responsibility to the competent authorities of the host Member State.

2. Paragraph 1 shall not prevent supervision on a consolidated basis pursuant to this Directive.

3. The competent authorities in one Member State shall have regard to the potential impact of their decisions on the stability of the financial system in all other Member States concerned and, in particular, in emergency situations."

Article 42

1. The competent authorities of the Member States concerned shall collaborate closely in order to supervise the activities of credit institutions operating, in particular through a branch, in one or more Member States other than that in which their head offices are situated. They shall supply one another with all information concerning the management and ownership of such credit institutions that is likely to facilitate their supervision and the examination of the conditions for their authorisation, and all information likely to facilitate the monitoring of such institutions, in particular with regard to liquidity, solvency, deposit guarantees, the limiting of large exposures, administrative and accounting procedures and internal control mechanisms.

2. The competent authorities of the home and the host Member State, and the consolidating supervisor where Article 129(1) applies, shall do everything within their power to reach a joint decision on the designation of branches as being systemically relevant.

The branch is deemed systemically relevant in view of its market share in the host Member State, the likely impact of a suspension or closure of the credit institution's operations on the payment and clearing and settlement system in the host Member State, or any other considerations pertaining to the size and importance of the branch in relation to the host Member State's banking or financial system. If the market share of a branch of a credit institution in terms of deposits exceeds [X%] in the host Member State, its systemic relevance must be assessed.

In the absence of a joint decision, the competent authority of the host Member State may make its own decision. In making its decision, it shall duly take into account any views and reservations of the competent authorities concerned.

The decisions referred to in the first and third subparagraph shall be set out in a document containing the fully reasoned decision, transmitted to the competent authorities concerned, recognised as determinative and applied by the competent authorities in the Member States concerned.

The designation of a branch as being systemically relevant shall not affect the rights and responsibilities of the competent authorities under this Directive with the exception of Article 42(3).

3. The competent authorities of the home Member State shall communicate to the competent authorities of a host Member State where a systemically relevant branch is established the information referred to in Article 132(1)(c) and (d) and carry out the tasks referred to in Article 129(1)(c) in cooperation with the competent authorities of the host Member State.

If a competent authority of a home Member State becomes aware of an emergency situation within a credit institution as referred to in Article 130(1), it shall alert and communicate as soon as is practicable with the authorities referred to in the last subparagraph of Article 49 and in Article 50 as set out in Article 130(1).

4. Where Article 129(3) does not apply, the competent authority of the home Member State supervising a credit institution with systemically relevant branches in other Member States shall establish and chair a college of supervisors to facilitate the cooperation under Articles 42(1) and 42(3). The competent authorities of the home and the host Member States shall have written coordination and cooperation arrangements in place. The

establishment of colleges shall not affect the rights and responsibilities of the competent authorities under this Directive.

Article 49

This Section shall not prevent a competent authority from transmitting information to the following for the purposes of their tasks:

(a) central banks and other bodies with a similar function in their capacity as monetary authorities; and
(b) where appropriate, to other public authorities responsible for overseeing payment systems.

This Section shall not prevent such authorities or bodies from communicating to the competent authorities such information as they may need for the purposes of Article 45.

Information received in this context shall be subject to the conditions of professional secrecy specified in Article 44(1).

In an emergency situation as referred to in Article 130(1), Member States shall allow competent authorities to communicate information to central banks in the EU when this information is relevant for the exercise of their respective statutory tasks, including the conduct of monetary policy, the oversight of payments and securities settlement systems, and the safeguarding of financial stability.

Article 50

Notwithstanding Articles 44(1) and 45, the Member States may, by virtue of provisions laid down by law, authorise the disclosure of certain information to other departments of their central government administrations responsible for legislation on the supervision of credit institutions, financial institutions, investment services and insurance companies and to inspectors acting on behalf of those departments.

However such disclosures may be made only where necessary for reasons of prudential control.

In an emergency situation as referred to in Article 130(1), Member States shall allow competent authorities to disclose information to the departments referred to in the first subparagraph in all Member States concerned.

Article 129

1. In addition to the obligations imposed by the provisions of this Directive, the competent authority responsible for the exercise of supervision on a consolidated basis of EU parent credit institutions and credit institutions controlled by EU parent financial holding companies shall carry out the following tasks:

(a) coordination of the gathering and dissemination of relevant or essential information in going concern and emergency situations;

(b) planning and coordination of supervisory activities in going concern ~~as well as in emergency~~ situations~~–~~, including in relation to the activities referred to in Articles 123, 124 and points 14 and 15 of Annex V, part 10, in cooperation with the competent authorities involved; and

(c) planning and coordination of supervisory activities in cooperation with the competent authorities involved, and if necessary with central banks, in preparation of and during emergency situations, including adverse developments in credit institutions or in financial markets. This includes exceptional measures referred to in Article 132(3)(b), the preparation of joint assessments, the implementation of contingency plans and communication to the public.

2. In the case of applications for the permissions referred to in Articles 84(1), 87(9) and 105 and in Annex III, Part 6, respectively, submitted by an EU parent credit institution and its subsidiaries, or jointly by the subsidiaries of an EU parent financial holding company, the competent authorities shall work together, in full consultation, to decide whether or not to grant the permission sought and to determine the terms and conditions, if any, to which such permission should be subject.

An application as referred to in the first subparagraph shall be submitted only to the competent authority referred to in paragraph 1.

The competent authorities shall do everything within their power to reach a joint decision on the application within six months. This joint decision shall be set out in a document containing the fully reasoned decision which shall be provided to the applicant by the competent authority referred to in paragraph 1.

The period referred to in subparagraph 3 shall begin on the date of receipt of the complete application by the competent authority referred to in paragraph 1. The competent authority referred to in paragraph 1 shall forward the complete application to the other competent authorities without delay.

During the period referred to in subparagraph 3, the consolidating supervisor shall, at the request of the applicant, or of any of the other competent authorities concerned, consult the Committee of European Banking Supervisors. The consolidating supervisor may consult the Committee on its own initiative. When the Committee is consulted, the period referred to in the third subparagraph shall be extended by two months. Where the Committee has been consulted, the competent authorities concerned shall duly consider such advice before taking their joint decision.

In the absence of a joint decision between the competent authorities ~~within 6 months~~ within the periods referred to in the third and fifth subparagraphs, the competent authority referred to in paragraph 1 shall make its own decision on the application. The decision shall be set out in a document containing the fully reasoned decision and shall take into account the views and reservations of the other competent authorities expressed during the periods referred to in the third and fifth subparagraphs. The decision shall be provided to the applicant and the other competent authorities by the competent authority referred to in paragraph 1.

The decisions referred to in the third and sixth ~~fifth~~ subparagraphs shall be recognised as determinative and applied by the competent authorities in the Member States concerned.

3. The consolidating supervisor shall establish colleges of supervisors to facilitate the exercise of its tasks referred to in the first and second paragraph and in Article 130. The establishment and functioning of colleges shall be based on the written arrangements referred to in Article 131. The Committee of European Banking Supervisors shall elaborate guidelines for the operational functioning of colleges.

The competent authorities responsible for the supervision of subsidiaries of an EU parent credit institution or an EU parent financial holding company and the competent authorities of a host country where systemically relevant branches are established may participate in colleges of supervisors. The consolidating supervisor shall chair the meetings of the college and shall decide which competent authority participates in a meeting or in an activity of the college. This decision shall take account of the relevance of the supervisory activity to be planned or coordinated for those authorities, and the obligations referred to in Articles 40(3) and 42(3). The competent authorities participating in the college shall apply Article 129(1)(c) having full regard to the work of other forums that may be established in this area.

The competent authorities participating in the colleges shall agree on the entrustment of tasks and delegation of responsibilities and cooperate closely, having regard to the obligations in Articles 40(3), 42 and 132.

The consolidating supervisor and the competent authority responsible for the supervision of subsidiaries of an EU parent credit institution or an EU parent financial holding company in a certain Member State, shall, within a reasonable period of time, do everything within their power to reach an agreement on the application of Articles 72(2) *(Disclosure requirements for 'significant' subsidiaries)*, 74(2) *(reporting for the calculation of minimum capital requirements)*, 113(1)(f) *(treatment of intra-group exposures for large exposures purposes)* and 136(2) *(own funds requirements in excess of the minimum level)* to these subsidiaries. Where these competent authorities disagree, the matter shall be referred for consultation to the Committee of European Banking Supervisors, which shall give its advice within two months. The competent authorities shall duly consider such advice before taking its final decision in accordance with their responsibilities under this Directive. This shall not affect the rights and responsibilities of the competent authorities under this Directive.

The consolidating supervisor shall inform the Committee of European Banking Supervisors of the activities of the college of supervisors, including in emergency situations.

Article 130

1. Where an emergency situation, including adverse developments in financial markets, arises ~~within a banking group~~, which potentially jeopardises the stability of the financial system in any of the Member States where entities of a group have been authorised or where systemically relevant branches are established, the competent authority responsible for the exercise of supervision on a consolidated basis shall, ~~as soon as is practicable~~ subject to Chapter 1, Section 2**,** alert as soon as is practicable, the authorities referred to in the last subparagraph of Article 49~~(a)~~ and in Article 50, and shall communicate all information that is essential for the pursuance of their tasks.

These obligations shall apply to all competent authorities under Articles 125 and 126 in relation to a particular group,–and to the competent authority identified under Article 129(1).

If the authority referred to in the last subparagraph of Article 49 becomes aware of a situation described in the first subparagraph, it shall alert as soon as is practicable the competent authorities identified in Articles 125 and 126.

Where possible, the competent authority and the authority referred to in the last subparagraph of Article 49 shall use existing defined channels of communication."

Changes to Directive 2006/49/EC

Article 38, paragraph 3

3. Articles 42(2), with the exception of its third subparagraph, and Article 42(3) of Directive 2006/48/EC shall apply mutatis mutandis to the supervision of investment firms that do not fulfil the criteria set out in Article 20(2) or 20(3) or the first subparagraph of Article 46.

The Commission services seek views on the proposed amendments relating to crisis management and home/host issues. In particular, views are sought on the definition of a systemically relevant branch and an appropriate level for the threshold in Article 42(2).

D. WAIVERS FOR COOPERATIVE BANK NETWORKS AND OTHER TECHNICAL AMENDMENTS

Co-operative Bank Networks

The CRD exempts banks organised in networks from certain requirements of the Capital Requirement Directives. For these exemptions to be allowed, the following criteria are to be fulfilled: i) the central institution of the network is jointly and severally liable for the commitments of its affiliates, ii) the solvency and liquidity of the central institution and of all the affiliates are monitored and supervised on a consolidated basis and iii) the central institution also has powers to instruct its affiliates. However, the central institution and its affiliates are required to meet these prudential requirements on a consolidated basis. The requirements in question are the following: submission of a programme of operations, the obligation to have at least two directors, minimum level of capital, provisions against risks, large exposure regime, etc.

This exemption applies only to bank networks set up before 1977 and for which provisions in national law were adopted by 1979. Because of these time limits, bank networks set up later cannot currently make use of this exemption. This problem especially affects banks in countries which acceded to the EU later than 1979. The Commission proposes the removal of these time limits in order to allow the same treatment to be applied to all bank networks meeting the eligibility criteria irrespective of when they were set up.

Technical changes

Since 2005, the Directorate General Internal Market and Services, Member States and the industry have worked together to reach agreement on the interpretation and practical implementation of the technical details of the CRD. As a result of the work carried out, instances have been identified where the CRD is unclear or does not achieve its objective in practice. Rectifying these instances does not introduce new obligations on institutions but only clarifies or ensures the workability of existing treatments.

Further technical adjustments relate to lessons learned during the current market turmoil. These concern the way that institutions should manage credit risk and liquidity risk in the context of securitisation transactions and the capital treatment of liquidity facilities for securitisations.

Changes to Directive 2006/48/EC

Co-operative Bank Networks

Article 3

1. One or more credit institutions situated in the same Member State and which are permanently affiliated~~, on 15 December 1977,~~ to a central body which supervises them and which is established in the same Member State, may be exempted from the requirements of Articles 7 and 11(1) if ~~no later than 15 December 1979~~, national law provides that:

(a) the commitments of the central body and affiliated institutions are joint and several liabilities or the commitments of its affiliated institutions are entirely guaranteed by the central body;

(b) the solvency and liquidity of the central body and of all the affiliated institutions are monitored as a whole on the basis of consolidated accounts; and

(c) the management of the central body is empowered to issue instructions to the management of the affiliated institutions.

~~Credit institutions operating locally which are permanently affiliated, subsequent to 15 December 1977, to a central body within the meaning of the first subparagraph, may benefit from the conditions laid down therein if they constitute normal additions to the network belonging to that central body.~~

~~In the case of credit institutions other than those which are set up in areas newly reclaimed from the sea or have resulted from scission or mergers of existing institutions dependent or answerable to the central body, the Commission, pursuant to the procedure referred to in Article 151(2) may lay down additional rules for the application of the second subparagraph including the repeal of exemptions provided for in the first subparagraph, where it is of the opinion that the affiliation of new institutions benefiting from the arrangements laid down in the second subparagraph might have an adverse effect on competition.~~

2. A credit institution referred to in the first subparagraph of paragraph 1, may also be exempted from the provisions of Articles 9 and 10, and also Title V, Chapter 2, Sections 2, 3, 4, 5 and 6 and Chapter 3 provided that, without prejudice to the application of those provisions to the central body, the whole as constituted by the central body together with its affiliated institutions is subject to those provisions on a consolidated basis.

In case of exemption, Articles 16, 23, 24, 25, 26(1) to (3) and 28 to 37 shall apply to the whole as constituted by the central body together with its affiliated institutions.

Technical changes

Article 87, paragraphs 11 and 12

(11) Where exposures in the form of a collective investment undertaking (CIU) meet the criteria set out in Annex VI, Part 1, points 77 and 78 and the credit institution is aware of all <u>or parts</u> of the underlying exposures of the CIU, the credit institution shall look through to those underlying exposures in order to calculate risk-weighted exposure amounts and expected loss amounts in accordance with the methods set out in this Subsection. <u>For the part of the underlying exposures of the CIU the credit institution is not aware of Art. 87(12) shall apply.</u>

Where the credit institution does not meet the conditions for using the methods set out in this Subsection <u>for all or parts of the underlying exposures of the CIU</u>, risk weighted exposure amounts and expected loss amounts shall be calculated in accordance with the following approaches:

(a) for exposures belonging to the exposure class referred to in point (e) of Article 86(1), the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. Where these exposures, taken together with the credit institution's direct exposures in this exposure class, are not material within the meaning of Article 89(2), Paragraph 1 of that Article may be applied subject to the approval of the competent authorities;

(b) for all other underlying exposures, the approach set out in Subsection 1, subject to the following modifications:

(i) for exposures subject to a specific risk weight for unrated exposures or subject to the highest [two] credit quality step[s] for a given exposure class, the risk weight is multiplied by a factor of 2 subject to a cap of 1250%;

~~(i) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure, and~~

(ii) for all other exposures, the risk weight is multiplied by a factor of [1,1] and subject to a minimum of [5%].

~~(ii) exposures assigned to the higher credit quality steps, to which a risk weight of 150 % would normally be attributed, are assigned a risk weight of 200 %.~~"

(12) Where exposures in the form of a CIU do not meet the criteria set out in Annex VI, Part 1, points 77 and 78, or the credit institution is not aware of all of the underlying exposures of the CIU, the credit institution shall look through to the underlying exposures and calculate risk-weighted exposure amounts and expected loss amounts in accordance with the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. For these purposes, non equity exposures are assigned to one of the classes (private equity, exchange traded equity or other equity) set out in Annex VII, Part 1, point 19 and unknown exposures are assigned to other equity class. Alternatively to the method described above, credit institutions may calculate themselves or may rely on a third party to calculate and report the average risk weighted exposure amounts based on the CIU's underlying exposures in accordance with the following approaches, provided that the correctness of the calculation and the report is adequately ensured:

(a) for exposures belonging to the exposure class referred to in point (e) of Article 86(1), the approach set out in Annex VII, Part 1, points 19 to 21. If, for those purposes, the credit institution is unable to differentiate between private equity, exchange-traded and other equity exposures, it shall treat the exposures concerned as other equity exposures. Where these exposures, taken together with the credit institution's direct exposures in this exposure class, are not material within the meaning of Article 89(2), paragraph 1 of that Article may be applied subject to the approval of the competent authorities; or

(b) for all other underlying exposures, the approach set out in Subsection 1, subject to the following modifications:

(i) for exposures subject to a specific risk weight for unrated exposures or subject to the highest [two] credit quality step[s] for a given exposure class, the risk weight is multiplied by a factor of 2 subject to a cap of 1250%;

~~(i) the exposures are assigned to the appropriate exposure class and attributed the risk weight of the credit quality step immediately above the credit quality step that would normally be assigned to the exposure, and~~

(ii) for all other exposures, the risk weight is multiplied by a factor of [1,1] and subject to a minimum of [5%].

~~(ii) exposures assigned to the higher credit quality steps, to which a risk weight of 150 % would normally be attributed, are assigned a risk weight of 200 %."~~

Article 89, paragraph 1, poin t(d)

~~(d) exposures to central governments of the home Member State and to their regional governments, local authorities and administrative bodies, provided that:~~

(d) exposures to central governments of the Member States and their regional governments, local authorities and administrative bodies provided that:

Article 95

1. Where significant credit risk associated with securitised exposures has been transferred from the originator credit institution in accordance with the terms of Annex IX, Part 2, that credit institution may:

(a) in the case of a traditional securitisation, exclude from its calculation of risk-weighted exposure amounts, and, as relevant, expected loss amounts, the exposures which it has securitised; and

(b) in the case of a synthetic securitisation, calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, in respect of the securitised exposures in accordance with Annex IX, Part 2.

2. Where paragraph 1 applies, the originator credit institution shall calculate the risk-weighted exposure amounts prescribed in Annex IX for the positions that it may hold in the securitisation. <u>The risk-weighted exposure amounts for the originator credit institution shall not be less than [15%] of the risk-weighted exposure amounts of the securitised exposures had they not been securitised.</u>

Where the originator credit institution fails to transfer significant credit risk in accordance with paragraph 1, it need not calculate risk-weighted exposure amounts for any positions it may have in the securitisation in question.

Article 150, paragraphs 1 and 2

1. Without prejudice, as regards own funds, to the proposal that the Commission is to submit pursuant to Article 62, the technical adjustments designed to amend non-essential elements of this Directive in the following areas shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 151(2):

(a) clarification of the definitions in order to take account, in the application of this Directive, of developments on financial markets;

(b) clarification of the definitions to ensure uniform application of this Directive;

(c) the alignment of terminology on, and the framing of definitions in accordance with, subsequent acts on credit institutions and related matters;

(d) technical adjustments to the list in Article 2;

(e) alteration of the amount of initial capital prescribed in Article 9 to take account of developments in the economic and monetary field;

(f) expansion of the content of the list referred to in Articles 23 and 24 and set out in Annex I or adaptation of the terminology used in that list to take account of developments on financial markets;

(g) the areas in which the competent authorities shall exchange information as listed in Article 42;

(h) technical adjustments in Articles 56 to 67 and in Article 74 as a result of developments in accounting standards or requirements which take account of Community legislation or with regard to convergence of supervisory practices;

(i) amendment of the list of exposure classes in Articles 79 and 86 in order to take account of developments on financial markets;

(j) the amount specified in Article 79(2)(c), Article 86(4)(a), Annex VII, Part 1, point 5 and Annex VII, Part 2, point 15 to take into account the effects of inflation;

(k) the list and classification of off-balance sheet items in Annexes II and IV ~~and their treatment in the determination of exposure values for the purposes of Title V, Chapter 2, Section 3~~; or

(l) adjustment of the provisions in Annexes III and V to XII in order to take account of developments on financial markets (in particular new financial products) or in accounting standards or requirements which take account of Community legislation, or with regard to convergence of supervisory practice. ;

(m) alteration of the amounts and the percentages specified in Article 111(1) to take account of developments on financial markets.

2. The Commission may adopt the following implementing measures:

(a) specification of the size of sudden and unexpected changes in the interest rates referred to in Article 124(5);

(b) a temporary reduction in the minimum level of own funds laid down in Article 75 and/or the risk weights laid down in Title V, Chapter 2, Section 3 in order to take account of specific circumstances;

(c) ~~without prejudice to the report referred to in Article 119,~~ clarifications of exemptions provided for in Article 111 (4)~~,~~ and 113 ~~113, 115 and 116~~;

(d) specification of the key aspects on which aggregate statistical data are to be disclosed under Article 144(1)(d);

(e) specification of the format, structure, contents list and annual publication date of the disclosures provided for in Article 144; or

(f) adjustments of the criteria set out in Article 19a(1), in order to take account of future developments and to ensure the uniform application of this Directive.

The measures referred to in points (a), (b), (c) and (f), designed to amend non-essential elements of this Directive by supplementing it, shall be adopted in accordance with the regulatory procedure with scrutiny referred to in Article 151(2). The measures referred to in points (d) and (e) shall be adopted in accordance with the regulatory procedure referred to in Article 151(2a).

The treatment of counterparty credit risk of derivative instruments, repurchase transactions, securities or commodities lending or borrowing transactions, long settlement transactions and margin lending transactions

Annex III, part 1, point 5

5. 'Netting Set' means a group of transactions with a single counterparty that are subject to a legally enforceable bilateral netting arrangement and for which netting is recognised under Part 7 of this Annex and Articles 90 to 93. Each transaction that is not subject to a legally enforceable bilateral netting arrangement, which is recognised under Part 7 of this Annex, should be interpreted as its own netting set for the purpose of this Annex. Under the method set out in Part 6 of this Annex (IMM), all netting sets with a single counterparty may be treated as single netting set if negative simulated market values of the individual netting sets are set to 0 in the estimation of expected exposure (EE).

Annex III, part 2, point 3

3. When a credit institution purchases credit derivative protection against a non-trading book exposure, or against a CCR exposure, it may compute its capital requirement for the hedged asset in accordance with Annex VIII, Part 3, points 83 to 92, or subject to the approval of the competent authorities, in accordance with Annex VII, Part 1, point 4 or Annex VII, Part 4, points 96 to 104. In these cases, and where the option in the second sentence of point 11 in Annex II of Directive 2006/49/EC is not applied, the exposure value for CCR for these credit derivatives is set to zero.

Notwithstanding the above, an institution may choose to consistently include for the purposes of calculating capital requirements for counterparty credit risk all credit derivatives not included in the trading book and purchased as protection against a non-trading book exposure or against a CCR exposure where the credit protection is recognised under this Directive.

Annex III, part 5, point 15

15. There is one hedging set for each issuer of a reference debt instrument that underlies a credit default swap. Nth to default' basket credit default swaps are treated as follows:

a) The size of a risk position in a reference debt instrument in a basket underlying an 'nth to default' credit default swap is the effective notional value of the reference debt instrument, multiplied by the modified duration of the 'nth to default' derivative with respect to a change in the credit spread of the reference debt instrument.

b) There is one hedging set for each reference debt instrument in a basket underlying a given 'nth to default' credit default swap. Risk positions from different 'nth to default' credit default swaps shall not be included in the same hedging set.

c) The CCR multiplier applicable to each hedging set created for one of the reference debt instruments of an 'nth to default' derivative is 0.3% for reference debt instruments that have a credit assessment from a recognised ECAI equivalent to credit quality step 1 to 3 and 0.6% for other debt instruments.

Changes to Directive 2006/49/EC

Article 45

1. Competent authorities may permit investment firms to exceed the limits concerning large exposures set out in Article 111 of Directive 2006/48/EC. Investment firms need not include any excesses in their calculation of capital requirements exceeding such limits, as set out in Article 75(b) of that Directive. This discretion is available until 31 December ~~2010~~ 2012 or the date of entry into force of any modifications consequent to the treatment of large exposures pursuant to Article 119 of Directive 2006/48/EC, whichever is the earlier. For this discretion to be exercised, the following conditions shall be met:

(a) the investment firm provides investment services or investment activities related to the financial instruments listed in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC;

(b) the investment firm does not provide such investment services or undertake such investment activities for, or on behalf of, retail clients;

c) breaches of the limits referred to in the introductory part of this paragraph arise in connection with exposures resulting from contracts that are financial instruments as listed in point (a) and relate to commodities or underlyings within the meaning of point 10 of Section C of Annex I to Directive 2004/39/EC (MiFID) and are calculated in accordance with Annexes III and IV of Directive 2006/48/EC, or in connection

with exposures resulting from contracts concerning the delivery of commodities or emission allowances; and

(d) the investment firm has a documented strategy for managing and, in particular, for controlling and limiting risks arising from the concentration of exposures.

Article 48

1. The provisions on capital requirements as laid down in this Directive and Directive 2006/48/EC shall not apply to investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC and to whom Directive 93/22/EEC (1) did not apply on 31 December 2006. This exemption is available until 31 December ~~2010~~ 2012 or the date of entry into force of any modifications pursuant to paragraphs 2 and 3, whichever is the earlier.

2. As part of the review required by Article 65(3) of Directive 2004/39/EC, the Commission shall, on the basis of public consultations and in the light of discussions with the competent authorities, report to the Parliament and the Council on:

(a) an appropriate regime for the prudential supervision of investment firms whose main business consists exclusively of the provision of investment services or activities in relation to the commodity derivatives or derivatives contracts set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC; and

(b) the desirability of amending Directive 2004/39/EC to create a further category of investment firm whose main business consists exclusively of the provision of investment services or activities in relation to the financial instruments set out in points 5, 6, 7, 9 and 10 of Section C of Annex I to Directive 2004/39/EC relating to energy supplies (including electricity, coal, gas and oil).

3. On the basis of the report referred to in paragraph 2, the Commission may submit proposals for amendments to this Directive and to Directive 2006/48/EC.

Co-operative Bank Networks

In your view should affiliates to networks meeting the eligibility criteria laid out in the CRD but set up after 15 December 1977 be allowed to make use of the same exemptions as the affiliates to networks set up before that date?

Technical Changes

Do you agree with the proposed changes?

AMENDMENTS SUBJECT TO THE COMITOLOGY PROCEDURE

E. TECHNICAL AMENDMENTS TO DIRECTIVE 2006/48/EC

Annexes V, VI, VII, VIII, IX, X and XII of Directive 2006/48/EC are amended as follows:

(1) Annex V is amended as follows:

(a) Point 3 is replaced by the following:

(i) Credit-granting shall be based on sound and well-defined criteria. This shall also be the case where the credit institution's exposure to the resulting credit risk is limited or eliminated because the credit risk has been transferred to or hedged by third parties.

(ii) Where credit risk is transferred to or hedged by third parties by a securitisation, internal policies and economic incentives shall be in place to ensure that the credit institution bases credit granting on sound and well-defined criteria for all exposures that are being originated in order to be securitised in full or in part. In particular, a credit institution shall consider on a case by case basis as appropriate in a given securitisation

- to select exposures to be securitised randomly from the set of contractually eligible exposures; or
- to retain securitisation positions in securitisations for which it originates exposures.

The policies applied to this end by the originator credit institution shall be publicly disclosed.

(iii) The process for approving, amending, renewing, and re-financing credits shall be clearly established.

(b) Point 8 is replaced by the following:

"The risks arising from securitisation transactions in relation to which the credit institutions are investor, originator or sponsor shall be evaluated and addressed through appropriate policies and procedures, to ensure in particular that the economic substance of the transaction is fully reflected in the risk assessment and management decisions."

(c) Point 14 is replaced by the following:

"Policies and processes for the measurement and management of their net funding position and requirements on an ongoing and forward-looking basis shall exist. Alternative scenarios shall be considered and the assumptions underpinning decisions concerning the net funding position shall be reviewed regularly. Alternative scenarios shall for these purposes in particular address off-balance sheet items and other contingent liabilities. The measurement and management of a credit institution's net funding position and alternative scenarios to be considered shall also take into account the assets and liabilities, including contingent liabilities, of SSPEs or other special purpose entities and in relation to which the credit institution acts as sponsor or provides material liquidity support."

(2) Annex VI, Part 1, is amended as follows:

(a) Point 6.4.29 is replaced by the following:

"6.4.29. Exposures to institutions with a ~~original effective~~ residual maturity of more than three months for which a credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 4 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale.

(b) In point 6.4.31, the introductory part is replaced by the following:

"6.4.31. Exposures to an institution ~~with an original effective maturity of three months or less~~ of up to three months residual maturity for which a credit assessment by a nominated ECAI is available shall be assigned a risk-weight according to Table 5 in accordance with the assignment by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale:"

(c) Point 14 is replaced by the following:

"14. ~~SHORT-TERM~~ EXPOSURES TO INSTITUTIONS AND CORPORATES WITH A SHORT-TERM CREDIT ASSESSMENT".

(d) In point 14.73, the introductory part is replaced by the following:

"14.73. Exposures to institutions where points 29 to 32 apply, and exposures to corporates ~~Short-term exposures to an institution or corporate~~ for which a short-term credit assessment by a nominated ECAI is available shall be assigned a risk weight according to Table 7 as follows, in accordance with the mapping by the competent authorities of the credit assessments of eligible ECAIs to six steps in a credit quality assessment scale:

(e) The following point 16.1.90 shall be inserted:

"16.1.90. The exposure value for leases shall be the discounted minimum lease payments. Minimum lease payments are the payments over the lease term that the lessee is or can be required to make and any bargain option (i.e. option the exercise of which is reasonably certain). Any guaranteed residual value fulfilling the set of conditions in Annex VIII, Part 1, points 26 to 28 regarding the eligibility of protection providers as well as the minimum requirements for recognising other types of guarantees provided in Annex VIII, Part 2, points 14 to 19 should also be included in the minimum lease payments. Those exposures shall be assigned to the relevant exposure class in accordance with Article 79. When the exposure is a residual value of leased properties, the risk weighted exposure amounts shall be calculated as follows: 1/t x 100% x exposure value, where t is the greater of 1 and the nearest number of whole years of the lease remaining."

(3) Annex VI, Part 2, is amended as follows:

(a) Point 1.4.7 is replaced by the following:

"Competent authorities shall take the necessary measures to assure that the principles of the methodology employed by the ECAI for the formulation

of its credit assessments are publicly available as to allow all potential users to decide whether they are derived in a reasonable way. Competent authorities shall furthermore take the necessary measures to assure that for credit assessments relating to securitisation positions, the ECAI is committed to make, on an ongoing basis, summary information on the structure of the transaction, the performance of pool assets and how this affects its credit assessment available to all credit institutions using the credit assessments for purposes of Article 96."

(4) Annex VII, Part 1, is amended as follows:

(a) Point 1.3.3.25 is replaced by the following:

"1.3.3.25. The risk weighted exposure amount shall be the potential loss on the credit institution's equity exposures as derived using internal value-at-risk models subject to the 99th percentile, one-tailed confidence interval of the difference between quarterly returns and an appropriate risk-free rate computed over a long-term sample period, multiplied by 12,5. The risk weighted exposure amounts at the ~~individual exposure~~ equity portfolio level shall not be less than the total of the sums of minimum risk weighted exposure amounts required under the PD/LGD Approach and the corresponding expected loss amounts multiplied by 12,5 and calculated on the basis of the PD values set out in Part 2, point 24~~(a)~~ and the corresponding LGD values set out in Part 2, points 25 and 26."

(b) Point 1.4.27 is replaced by the following:

"1.4.27. The risk weighted exposure amounts shall be calculated according to the formula:

Risk-weighted exposure amount=100% x exposure value,

except for when the exposure is a residual value of leased properties in which case it ~~should be provisioned for each year and~~ will be calculated as follows:

1/t x 100% x exposure value,

Where t is the greater of 1 and the nearest number of whole years of the lease remaining."

(5) Annex VII, Part 2, is amended as follows:

(a) Point 1.3.13 (c) is replaced by the following:

"1.3.13. (c) For exposures arising from fully or nearly-fully collateralised derivative instruments (listed in Annex IV) transactions and fully or nearly-fully collateralised margin lending transactions which are subject to a master netting agreement, M shall be the weighted average remaining maturity of the transactions where M shall be at least 10 days. For repurchase transactions or securities or commodities lending or borrowing transactions which are subject to a master netting agreement, M shall be the weighted average remaining maturity of the transactions where M shall be at

least 5 days. The notional amount of each transaction shall be used for weighting the maturity."

(b) In point 1.3.14, the introductory part is replaced by the following:

"Notwithstanding point 13(a), (b), (c), (d) and (e), M shall be at least one-day for:"

(6) Annex VII is amended as follows:

(a) In Part 4, Point 2.2.4.96 is replaced by the following:

"2.2.4.96. The requirements in points 97 to 104 shall not apply for guarantees provided by institutions, ~~and~~ central governments and central banks, and corporate entities which meet the requirements laid down in Annex VIII, part 1, point 26 (g) if the credit institution has received approval to apply the rules of Articles 78 to 83 for exposures to such entities. In this case the requirements of Articles 90 to 93 shall apply."

(7) Annex VIII, Part 1 is amended as follows:

(a) Point 1.3.1.9 is amended as follows:

(i) The following paragraph is added at the end:

"If the collective investment undertaking is not limited to investing in instruments that are eligible for recognition under point 7 and 8, units may be recognised with the value of the eligible assets as collateral under the assumption that the CIU has invested to the maximum extent allowed under its mandate in assets that are not eligible. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the credit institution shall calculate the total value of the non-eligible assets and shall reduce the value of the eligible assets by that of the non-eligible in case the latter is negative in total."

(b) Point 1.3.2.11 is amended as follows:

(i) The following paragraph is added at the end:

"If the collective investment undertaking is not limited to investing in instruments that are eligible for recognition under point 7 and 8 and the items mentioned in point (a) of this point, units may be recognised with the value of the eligible assets as collateral under the assumption that the CIU has invested to the maximum extent allowed under its mandate in assets that are not eligible. In cases where non-eligible assets can have a negative value due to liabilities or contingent liabilities resulting from ownership, the credit institution shall calculate the total value of the non-eligible assets and shall reduce the value of the eligible assets by that of the non-eligible in case the latter is negative in total."

(8) Annex VIII, Part 2, is amended as follows:

(a) Point 1.8.2.13 is replaced by the following:

"13. For life insurance policies pledged to the lending credit institution to be recognised the following conditions shall be met:

~~(a) the company providing the life insurance may be recognised as an eligible unfunded credit protection provider under Part 1, point 26;~~
(a) the life insurance policy is openly pledged or assigned to the lending credit institution;
(b) the company providing the life insurance is notified of the pledge or assignment and as a result may not pay amounts payable under the contract without the consent of the lending credit institution;
~~(d) the declared surrender value of the policy is non-reducible;~~
(c) the lending credit institution must have the right to cancel the policy and receive the surrender value ~~in a timely way~~ in the event of the default of the borrower;
(d) the lending credit institution is informed of any non-payments under the policy by the policy-holder;
(e) the credit protection must be provided for the maturity of the loan. Where this is not possible because the insurance relationship ends before the loan relationship expires, the credit institution must ensure that the amount deriving from the insurance contract serves the credit institution as security until the end of the duration of the credit agreement; and
(f) the pledge or assignment must be legally effective and enforceable in all jurisdictions which are relevant at the time of the conclusion of the credit agreement.
(g) the surrender value is declared by the company providing the life insurance and is non-reducible,
(h) the surrender value is to be paid in a timely manner upon request,
(i) the surrender value cannot be requested without the consent of the credit institution,
(j) the company providing the life insurance is subject to the Directives 2002/83/EC of the European Parliament and of the Council of 5 November 2002 concerning life assurance and 2001/17/EC of the European Parliament and of the Council of 19 March 2001 on the reorganisation and winding-up of insurance undertakings or is subject to supervision by a competent authority of a third country which applies supervisory and regulatory arrangements at least equivalent to those applied in the Community, and
~~(k) the company providing the life insurance holds assets over which the beneficiaries have a claim that is prior to any other claims when the company defaults on liabilities that are due and whose time value is at least as high as the sum of the declared surrender values of the outstanding policies.~~"

(b) In point 2.2.16, the introductory part is replaced by the following:

"2.2.16. Where an exposure is protected by a guarantee which is counter-guaranteed by a central government or central bank, a regional government or local authority, a public sector entity, claims on which are treated as claims on the central government in whose jurisdiction they are established under Articles 78 to 83, a multi-lateral development bank or an international organisation, to which a 0 % risk weight is assigned under or by virtue of Articles 78 to 83, or a public sector entity, claims on which are treated as claims on credit institutions under Articles 78 to 83, the exposure

may be treated as protected by a guarantee provided by the entity in question, provided the following conditions are satisfied:"

(9) Annex VIII, Part 3, is amended as follows:

(a) Point 1.4.1.24 is replaced by the following:

"1.4.1.24. The Financial Collateral Simple Method shall be available only where risk-weighted exposure amounts are calculated under Articles 78 to 83. A credit institution shall not use both the Financial Collateral Simple Method and the Financial Collateral Comprehensive Method, unless for the purposes of Article 85(1) and 89(1). Credit institutions shall demonstrate to the competent authorities that this exceptional treatment is not used selectively with the purpose of achieving reduced minimum capital requirements and does not lead to regulatory arbitrage."

(b) Point 1.4.1.26 is replaced by the following:

"1.4.1.26. The risk weight that would be assigned under Articles 78 to 83 if the lender had a direct exposure to the collateral instrument shall be assigned to those portions of ~~claims~~ exposure values collateralised by the market value of recognised collateral. For this purpose, the exposure value of an off-balance sheet item listed in Annex II shall be 100 % of its value rather than the exposure value indicated in Article 78(1). The risk weight of the collateralised portion shall be a minimum of 20 % except as specified in points 27 to 29. The remainder of the exposure value shall receive the risk weight that would be assigned to an unsecured exposure to the counterparty under Articles 78 to 83."

(c) In point 1.4.2.33 the second sentence is replaced by the following:

"Where:

E is the exposure value as would be determined under Articles 78 to 83 or Articles 84 to 89 as appropriate if the exposure was not collateralised. For this purpose, for credit institutions calculating risk-weighted exposure amounts under Articles 78 to 83, the exposure value of an off-balance sheet item listed in Annex II shall be 100 % of its value rather than the exposure value ~~percentage~~ indicated in Article 78(1), and for credit institutions calculating risk-weighted exposure amounts under Articles 84 to 89, the exposure value of the items listed in Annex VII, Part 3, points 9 to 11 shall be calculated using a conversion factor of 100 % rather than the conversion factors or percentages indicated in those points."

(d) In point 1.5.2.69, the following sentence is added:

"For this purpose, the exposure value of the items listed in Annex VII, Part 3, points 9 to 11 shall be calculated using a conversion factor or percentage of 100 % rather than the conversion factors or percentages indicated in those points".

(e) Point 1.5.2.75 is replaced by the following:

"1.5.2.75. When the discretion provided for in point 73 is exercised by the competent authorities of a Member State, ~~The competent authorities, which do not authorise the treatment in point 73,~~ the competent authorities of another Member State may authorise their credit institutions to assign the risk weights permitted under the treatment of point 73 in respect of exposures collateralised by residential real estate property or commercial real estate property located in the territory of the former ~~those~~ Member State~~s the competent authorities of which authorise this treatment~~ subject to the same conditions as apply in ~~that~~ the former Member State."

(f) Point 1.7.2.80 is replaced by the following:

"Where the conditions set out in Part 2, point 13 are satisfied, ~~credit protection falling within the terms of Part 1, point 24 may be treated as a guarantee by the company providing the life insurance. The value of the credit protection recognised shall be the current surrender value of the life insurance policy.~~ the portion of the exposure collateralised by the current surrender value of credit protection falling within the terms of Part 1, point 24 shall be
- subject to the risk weights specified in point 80 bis where the exposure is subject to Articles 78 to 83; or
- assigned an LGD of 40% where the exposure is subject to Articles 84 to 89-but not subject to the credit institution's own estimates of LGD."

(g) A new point 1.7.2.80 bis is added:

"80 bis. For purposes of the first indent in point 80, the following risk weights shall be assigned on the basis of the risk weight assigned to a senior unsecured exposure to the company providing the life insurance:
(a) if the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 20%, a risk weight of 20%;
(b) if the senior unsecured exposure to the company providing the life insurance is assigned a risk weight or 50%, a risk weight of 35%;
(c) if the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 100%, a risk weight of 70%;
(d) if the senior unsecured exposure to the company providing the life insurance is assigned a risk weight of 150%, a risk weight of 150%."
In case of a currency mismatch, the above risk weights shall be subject to an adjustment as set out in points 84 and 85.

(h) Point 2.2.2.87 is replaced by the following:

"2.2.2.87. For the purposes of Article 80, g shall be the risk weight to be assigned to an exposure, the exposure value (E) of which is fully protected by unfunded protection (G_A), where:

E is the exposure value according to Article 78; for this purpose, the exposure value of an off-balance sheet item listed in Annex II shall be 100 % of its value rather than the exposure value indicated in Article 78(1);

g is the risk weight of exposures to the protection provider as specified under Articles 78 to 83; and

G_A is the value of G* as calculated under point 84 further adjusted for any maturity mismatch as laid down in Part 4."

(i) In point 2.2.2.88, the second sentence is replaced by the following:

"where:

E is the exposure value <u>according to Article 78. For this purpose, the exposure value of an off-balance sheet item listed in Annex II shall be 100 % of its value rather than the exposure value indicated in Article 78(1); </u>"

(j) Point 2.2.3.90 is replaced by the following:

"2.2.3.90. For the covered portion of the exposure <u>value (E)</u> (based on the adjusted value of the credit protection G_A), the PD for the purposes of Annex VII, Part 2 may be the PD of the protection provider, or a PD between that of the borrower and that of the guarantor if a full substitution is deemed not to be warranted. In the case of subordinated exposures and non-subordinated unfunded protection, the LGD to be applied for the purposes of Annex VII, Part 2 may be that associated with senior claims. "

(k) Point 2.2.3.91 is replaced by the following:

"2.2.3.91. For any uncovered portion of the exposure<u> value (E)</u> the PD shall be that of the borrower and the LGD shall be that of the underlying exposure."

(l) Point 2.2.3.92 is replaced by the following:

"2.2.3.92. G_A is the value of G* as calculated under point 84 further adjusted for any maturity mismatch as laid down in Part 4. E is the exposure value according to Annex VII, Part 3. <u>For this purpose, the exposure value of the items listed in Annex VII, Part 3, points 9 to 11 shall be calculated using a conversion factor or percentage of 100 % rather than the conversion factors or percentages indicated in those points."</u>

(10) Annex IX, Part 2 is amended as follows:

(a) The introductory sentence of point 1.1 is replaced by the following:

"1.1. The originator credit institution of a traditional securitisation may exclude securitised exposures from the calculation of risk-weighted exposure amounts and expected loss amounts if
<u>(i)</u> significant credit risk associated with the securitised exposures ~~has~~ <u>is considered to have</u> been transferred to third parties; <u>or</u>
<u>(ii) if the originator credit institution applies a 1250% risk weight to all securitisation positions he holds in this securitisation or deducts these securitisation positions from own funds according to Article 57(r).</u>

<u>Unless the competent authority decides on a case- by-case basis that a possible reduction in risk weighted exposure amounts that the originator credit institution would achieve by this securitisation is not justified by a commensurate and</u>

material transfer of credit risk to third parties, significant credit risk shall be considered to have been transferred if

(i) the risk-weighted exposure amounts of the mezzanine securitisation positions that are held by the originator credit institution in this securitisation do not exceed 50% of the risk weighted exposure amounts of all mezzanine securitisation positions that exist in this securitisation.; or if,

(ii) where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from own funds or a 1250 % risk weight exceeds a conservative estimate of the expected loss on the securitised exposures by a substantial margin, the originator credit institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from own funds or a 1250 % risk weight.

For these purposes, mezzanine securitisation positions shall mean securitisation positions to which a risk weight lower than 1 250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation positions in this securitisation to which

- in the case of a securitisation position subject to paragraph 6 to 36 of part 4 of this annex a credit quality step 1 or
- in the case of a securitisation position subject to paragraph 37 to 76 of part 4 of this annex a credit quality step 1 or 2 is assigned under Part 3 of this annex applies.

Notwithstanding the above, the competent authority may decide on a case-by-case basis that significant credit risk may be considered to have been transferred if the competent authority is satisfied that a possible reduction of capital requirements that the originator achieves by the securitisation is justified by a commensurate and material transfer of credit risk to third parties. The competent authorities shall only be satisfied if the originator credit institution can demonstrate that such transfer of credit risk to third parties is also assumed for purposes of the credit institutions internal risk management and its internal capital allocation. The compliance with this condition shall be periodically reviewed.

~~and the transfer complies with~~In addition, all of the following conditions shall be met:"

[here all the existing criteria (a) to (g) follow]

(b) The introductory sentence of point 2.2 is replaced by the following:

"2.2. An originator credit institution of a synthetic securitisation may calculate risk-weighted exposure amounts, and, as relevant, expected loss amounts, for the securitised exposures in accordance with points 3 and 4 below, if

(i) significant credit risk ~~has~~ is considered to have been transferred to third parties either through funded or unfunded credit protection; or

(ii) the originator credit institution applies a 1250% risk weight to all securitisation positions he holds in this securitisation or deducts these securitisation positions from own funds according to Article 57(r).

Unless the competent authority decides on a case- by-case basis that a possible reduction in risk weighted exposure amounts that the originator credit institution would achieve by this securitisation is not justified by a commensurate and material transfer of credit risk to third parties, significant credit risk shall be considered to have been transferred if
(i) the risk-weighted exposure amounts of the mezzanine securitisation positions that are held by the originator credit institution in this securitisation do not exceed 50% of the risk weighted exposure amounts of all mezzanine securitisation positions that exist in this securitisation.; or if,
(ii) where there are no mezzanine securitisation positions in a given securitisation and the originator can demonstrate that the exposure value of the securitisation positions that would be subject to deduction from own funds or a 1250 % risk weight exceeds a conservative estimate of the expected loss on the securitised exposures by a substantial margin, the originator credit institution does not hold more than 20 % of the exposure values of the securitisation positions that would be subject to deduction from own funds or a 1250 % risk weight.

For these purposes, mezzanine securitisation positions shall mean securitisation positions to which a risk weight lower than 1 250 % applies and that are more junior than the most senior position in this securitisation and more junior than any securitisation positions in this securitisation to which

- in the case of a securitisation position subject to paragraph 6 to 36 of part 4 of this annex a credit quality step 1 or
- in the case of a securitisation position subject to paragraph 37 to 76 of part 4 of this annex a credit quality step 1 or 2 is assigned under Part 3 of this annex applies.

Notwithstanding the above, the competent authority may decide on a case-by-case basis that significant credit risk may be considered to have been transferred if the competent authority is satisfied that a possible reduction of capital requirements that the originator achieves by the securitisation is justified by a commensurate and material transfer of credit risk to third parties. The competent authorities shall only be satisfied if the originator credit institution can demonstrate that such transfer of credit risk to third parties is also assumed for purposes of the credit institutions internal risk management and its internal capital allocation. The compliance with this condition shall be periodically reviewed.

In addition, the transfer shall comply~~ies~~ with the following conditions:"

[here all the existing criteria (a) to (d) follow]

(11) Annex IX, Part 4, is amended as follows:

(a) Point 2.4.2, point 2.4.2.14, point 3.5.1 and point 3.5.1.56 are deleted.

~~2.4.2. **Liquidity facilities that may be drawn only in the event of a general market disruption**~~

~~14. To determine its exposure value, a conversion figure of 0 % may be applied to the nominal amount of a liquidity facility that may be drawn only in the event of a general market disruption (i.e. where more than one SPE across different transactions are unable to roll over maturing commercial paper and that inability is not the result of an impairment of the SPE's credit quality or of the credit quality of the securitised exposures), provided that the conditions set out in point 13 are satisfied.~~

~~3.5.1. **Liquidity Facilities Only Available in the Event of General Market Disruption**~~

~~56. A conversion figure of 20 % may be applied to the nominal amount of a liquidity facility that may only be drawn in the event of a general market disruption and that meets the conditions to be an 'eligible liquidity facility' set out in point 13.~~

(b) In point 2.4.1.13 the introductory sentence is replaced by the following:

> "When the following conditions are met, to determine its exposure value a conversion figure 50% ~~20%~~ may be applied to the nominal amount of a liquidity facility ~~with an original maturity of one year or less and a conversion figure of 50 % may be applied to the nominal amount of a liquidity facility with an original maturity of more than one yea:~~"

(c) Point 3.3.48 is deleted.

> ~~48. A risk weight of 6 % may be applied to a position in the most senior tranche of a securitisation where that tranche is senior in all respects to another tranche of the securitisation positions which would receive a risk weight of 7 % under point 46, provided that:~~
>
> ~~(a) the competent authority is satisfied that this is justified due to the loss absorption qualities of subordinate tranches in the securitisation; and~~
>
> ~~(b) either the position has an external credit assessment which has been determined to be associated with credit quality step 1 in Table 4 or 5 or, if it is unrated, requirements (a) to (c) in point 42 are satisfied where 'reference positions' are taken to mean positions in the subordinate tranche which would receive a risk weight of 7 % under point 46.~~

(12) Annex X, Part 2, is amended as follows:

(a) Point 1.1 is replaced by the following:

> "1.1. ~~Under the Standardised Approach, the capital requirement for operational risk is the average over three years of the risk-weighted relevant indicators calculated each year across the business lines referred to in Table 2. In each year, a negative capital requirement in one business line, resulting from a negative relevant indicator may be imputed to the whole.~~ The total capital charge is calculated as the three-year average of the yearly summations of the regulatory capital charges across business lines referred to in Table 2. In any given year, negative capital charges

(resulting from negative gross income) in any business line may offset positive capital charges in other business lines without limit. However, where the aggregate capital charge across all business lines within a given year is negative, the input to the numerator for that year will be zero."

(13) Annex X, Part 3, is amended as follows:

(a) Point 1.2.2.14 is replaced by the following:

"1.2.2.14. "Credit institutions must be able to map their historical internal loss data into the business lines defined in Part 2 and into the event types defined in Part 5, and to provide these data to competent authorities upon request. Loss events which affect the entire institution may be allocated to an additional business line 'corporate items' due to exceptional circumstances. There must be documented, objective criteria for allocating losses to the specified business lines and event types. The operational risk losses that are related to credit risk and have historically been included in the internal credit risk databases must be recorded in the operational risk databases and be separately identified. Such losses will not be subject to the operational risk charge, as long as they continue to be treated as credit risk for the purposes of calculating minimum capital requirements. Operational risk losses that are related to market risks shall be included in the scope of the capital requirement for operational risk."

(14) In Annex XII, part 2, point 10 is replaced by the following:

"10. The following information shall be disclosed by each credit institution which calculates its capital requirements in accordance with Annex V to Directive 2006/49/EC:

(a) for each sub-portfolio covered:

(i) the characteristics of the models used;

(ii) a description of stress testing applied to the sub-portfolio;

(iii) a description of the approaches used for back-testing and validating the accuracy and consistency of the internal models and modelling processes;

(b) the scope of acceptance by the competent authority;

(c) a description of the extent and methodologies for compliance with the requirements set out in Annex VII, Part B to Directive 2006/49/EC;

(d) the highest, the lowest and the mean of the daily value-at-risk measures over the reporting period and the value-at-risk measure as per the period end;

(e) a comparison of the daily end-of-day value-at-risk measures to the one-day changes of the portfolio's value by the end of the subsequent business day together with an analysis of any important overshootings during the reporting period."

(15) Annex XII, Part 3, is amended as follows:

(c) Point 3 is replaced by the following:

"3. The credit institutions using the approach set out in Article 105 for the calculation of their own funds requirements for operational risk shall disclose a description of the use of insurances and other risk transfer mechanisms for the purpose of mitigation the risk."

F. TECHNICAL AMENDMENTS TO DIRECTIVE 2006/49/EC

Annexes I, II,V and VII of Directive 2006/49/EC are amended as follows:

(1) Annex I, is amended as follows:

(a) Point 8. B is replaced by the following:

"B. TREATMENT OF THE PROTECTION BUYER

For the party who transfers credit risk (the 'protection buyer'), the positions are determined as the mirror principle of the protection seller, with the exception of a credit linked note (which entails no short position in the issuer). If at a given moment there is a call option in combination with a step-up, such moment is treated as the maturity of the protection. In the case of first to default credit derivatives and nth to default credit derivatives, ~~protection buyers are allowed to off-set specific risk for n-1 of the underlyings (i.e., the n-1 assets with the lowest specific risk charge)~~ the following treatment applies.

FIRST-TO-DEFAULT CREDIT DERIVATIVES

Where an institution obtains credit protection for a number of reference entities underlying a credit derivative under terms that the first default among the assets shall trigger payment and that this credit event shall terminate the contract, the institution may off-set specific risk for the reference entities to which the lowest specific risk percentage charge among the underlying reference entities would apply according to Table 1 of this Annex.

NTH-TO-DEFAULT CREDIT DERIVATIVES

Where the nth default among the exposures triggers payment under the credit protection, the protection buyer may only off-set specific risk if protection has also been obtained for defaults 1 to n-1 or when n-1 defaults have already occurred. In such cases, the methodology shall follow that set out above for first-to-default credit derivatives appropriately modified for nth-to-default products."

(b) In point 14, Table 1 is replaced by the following:

Table 1

Categories	Specific risk capital charge
Debt securities issued or guaranteed by central governments, issued by central	0%

banks, international organisations, multilateral development banks or Member States' regional government or local authorities which would qualify for credit quality step 1 or which would receive a 0 % risk weight under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC.	
Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional governments or local authorities which would qualify for credit quality step 2 or 3 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by institutions which would qualify for credit quality step 1 or 2 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules for the risk weighting of exposures under point 28, Part 1 of Annex VI to Directive 2006/48/EC, and debt securities issued or guaranteed by corporates which would qualify for credit quality step 1, 2 or 3 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC. Other qualifying items as defined in point 15.	0.25% (residual term to final maturity 6 months or less) 1.00% (residual term to final maturity greater than 6 months and up to and including 24 months) 1.60% (residual term to maturity exceeding 24 months)
Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional governments or local authorities or institutions which would qualify for credit quality step 4 or 5 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by institutions which would qualify for credit quality step 3 under the rules for the risk weighting of exposures under point 26 of Part 1 of Annex VI to Directive 2006/48/EC, and debt securities issued or guaranteed by corporates which would qualify for credit quality step ~~3 or~~ 4	8.00%

under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC. Exposures for which a credit assessment by a nominated ECAI is not available	
Debt securities issued or guaranteed by central governments, issued by central banks, international organisations, multilateral development banks or Member States' regional governments or local authorities or institutions which would qualify for credit quality step 6 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC, and debt securities issued or guaranteed by corporates which would qualify for credit quality step 5 or 6 under the rules for the risk weighting of exposures under Articles 78 to 83 of Directive 2006/48/EC.	12.00%

(2) Annex II, is amended as follows:

(a) Point 11 is replaced by the following:

"11. Where a credit derivative included in the trading book forms part of an internal hedge and the credit protection is recognised under Directive 2006/48/EC, there shall be deemed not to be counterparty risk arising from the position in the credit derivative. Alternatively, an institution may consistently include for the purposes of calculating capital requirements for counterparty credit risk all credit derivatives included in the trading book forming part of internal hedges where the credit protection is recognised under Directive 2006/48/EC."

(4) Annex VII, Part C is amended as follows:

(a) Point 3 is replaced by the following:

"3. Notwithstanding points 1 and 2, when an institution hedges a non-trading book credit risk exposure using a credit derivative booked in its trading book (using an internal hedge), the non-trading book exposure is not deemed to be hedged for the purposes of calculating capital requirements unless the institution purchases from an eligible third party protection provider a credit derivative meeting the requirements set out in point 19 of Part 2 of Annex VIII to Directive 2006/48/EC with regard to the non trading book exposure. Without prejudice to the second sentence of point 11 in Annex II, where such third party protection is purchased and recognised as a hedge of a non-trading book exposure for the purposes of calculating capital requirements, neither the internal nor external credit derivative hedge shall be included in the trading book for the purposes of calculating capital requirements."

The Commission Services seek views on the above technical changes and if they achieve the aim of clarifying or correcting the respective provisions of the directive. In particular, views are sought on the adjusted treatments for:

CIUs under the IRB in Article 87(11) and (12) and in particular on the calibration of the factors in square brackets;

Life insurance as collateral and whether the risk weights and supervisory LGD are commensurate with the additional protection due to the preferential status of a life insurance claim compared to a "normal" claim on the insurance provider.

In the context of securitisation, views are sought on the effectiveness of the proposed changes in improving risk management and making appropriate adjustments to certain capital treatments.