

MFSA

MALTA FINANCIAL SERVICES AUTHORITY

Securities Unit

6th February 2006

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The Compliance Officer

Dear Sir / Madam

Notification of Proposed Changes to the Investment Services Guidelines - Part CI:

Deletion of SLC 14.04 and/ 14.05

Revision of SLC 3.08

Please refer to the above-quoted standard licence conditions. The purpose of this notification is to bring to your attention the following proposed amendments to these conditions:

1.0 Deletion of SLC 14.04 and 14.05

The source of these conditions were similar provisions in the Malta Stock Exchange ('MSE') Bye-Laws which have since been removed from the Bye-Laws following the transfer of the regulation of providers of stockbroking services from the MSE to the MFSA.

SLC 14.04 is primarily aimed at preventing conflicts of interest which may arise when a person who provides stockbroking services, is connected to an issuer of listed securities. Whereas under the previous MSE regime, the services stockbrokers were permitted to provide, included the provision of advice and portfolio management in relation to MSE-listed securities, under the Investment Services Act regime, the investment services of 'stockbroking', 'investment advice' and 'portfolio management' are separate and distinct, with 'stockbroking' to be interpreted as limited to trading¹. Accordingly, Licence Holders wishing to provide stockbroking services, investment advice and/or portfolio management, need to have staff specifically authorised to provide each of such services.

The MFSA is of the view that SLC 14.04 may be deleted provided the current **SLC 3.08** is amended. The reason is that it is considered that a conflict of interest may only arise where investment advice or discretionary portfolio management services are provided, rather than when the investment service provided is limited to stockbroking or simply

¹ First Schedule of the ISA, Para 6: *'Carrying on the business of purchasing, selling or otherwise trading instruments quoted on a recognized investment exchange for and on behalf of a third party or parties'*

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trading on an execution-only basis. Details pertaining to the proposed revision to SLC 3.08 are provided in section 2.0 of this letter.

With regards to **SLC 14.05**, the main purpose behind this requirement was that of seeking to minimise the risk of stockbrokers seeking to speculate on the local market through short-term trading, and to minimise the risk of market manipulation.

The above-mentioned conditions were introduced at a time when market monitoring and investigation of suspicious trading was at its inception and when the legislation which regulated the area of market malpractice, did not provide for all the safeguards which today may be found in local legislation - primarily the Prevention of Financial Market Abuse Act (PFMA) which came into force in 2005. Moreover, issues concerning conflicts of interest are dealt with in other provisions of local legislation such as the Prevention of Financial Markets Abuse (Fair Presentation of Investment Recommendations and Disclosure of Conflicts of Interest) Regulations 2005 as well as in **SLC 3.02(b)** and **SLC 3.08** of Part C.I of the Investment Services Guidelines.

With regards to **SLC 14.05**, MFSA is of the view that this is overly restrictive and somewhat superfluous given the PFMA regime currently in force and may therefore also be deleted.

2.0 Revisions to SLC 3.08

2.1 Presently SLC 3.08 provides as follows:

For the purposes of this licence condition, the following definitions shall apply:

“restricted person”: the Licence Holder, or any of its partners, directors or employees who is also a director or employee of, or who occupies any other position of trust with, an associated issuer;

“associated issuer”: the issuer of a listed security in relation to which a person is a “restricted person” as defined in this condition, subject to open ended schemes being excluded from this definition.

The Licence Holder, its partners, directors and employees shall avoid placing themselves in a situation where a conflict with the interest of customers may arise. Standard condition 3.02 (b) addresses cases where it is not possible to avoid such situations. In addition:

a. a person shall obtain the permission of the MFSA before taking up an appointment which would make him a restricted person. Provided that persons authorised to trade on a RIE in the course of provision of stockbroking services, shall not be granted such permission and are required to comply with SLC 14.04;

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b. subject to the proviso set out below, a restricted person shall be prohibited from undertaking any activity falling within the scope of the Act in relation to either the shares or the affairs of:

- i. the associated issuer; or*
- ii. an issuer of a listed security in the same business sector or industry in Malta as the associated issuer; or*
- iii. an issuer of a listed security which has a close business relationship with the associated issuer;*

provided that the above restrictions shall not apply to dealing or arranging deals in securities on behalf of and on the instructions of a customer (or his independent and authorised adviser) as long as it can clearly be shown that the customer has been informed of the situation and that the deal is undertaken without any advice being given or any discretion being exercised by the restricted person nor shall the Licence Holder where it is itself a restricted person, be prohibited from holding securities on behalf of customers, whether or not as trustee, custodian or nominee as long as the customer has been informed of the situation;

c. whenever attending a meeting of the Board or of any committee or subcommittee of the associated issuer, a restricted person shall declare an interest and withdraw from the meeting if there is to be a discussion of, or the taking of a decision in relation to, the affairs of any other issuer of listed securities which has a close business relationship with the associated issuer. In addition, a restricted person shall not seek to obtain information concerning such matters from any other director or employee of, or person occupying a position of trust with, the associated issuer;

d. a restricted person shall not discuss with or provide any information to any shareholder, partner, director or employee of a Licence Holder in respect of either the shares or the affairs of:

- i. the associated issuer; or*
- ii. an issuer of a listed security in the same business sector or industry in Malta as the associated issuer; or*
- iii. an issuer of a listed security which has a close business relationship with the associated issuer.*

All partners, directors and employees of a Licence Holder shall make every effort to ensure that the requirements of this condition are met.

2.2 Proposed Revised SLC 3.08:

MFSA is of the view that the above SLC needs to be revised in order to: (a) remove reference to SLC 14.04 given its proposed deletion and to ensure all Licence Holders are subject to the requirements of SLC 3.08; (b) cater for a scenario where the Licence

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Holder may also itself be an issuer of Listed Securities²; and (c) simplify and clarify the wording of this SLC to facilitate its interpretation. The following revised SLC 3.08 is being proposed:

The Licence Holder, its partners, directors and employees shall avoid placing themselves in a situation where a conflict with the interest of customers may arise. Standard licence condition 3.02 (b) addresses cases where it is not possible to avoid such situations. In addition:

- a. *No director, partner or employee of a Licence Holder may take up an appointment as a Director or employee of an issuer of a Listed Security, or occupy a position of trust with such issuer, without the permission of the MFSA. 'Issuer of a Listed Security' in this context shall hereafter be referred to as 'the associated issuer' and shall exclude open-ended collective investment schemes which are not exchange-traded.*

No such person (hereinafter referred to as 'the restricted person') shall be permitted to provide investment advice or discretionary portfolio management services in relation to the securities of:

- i) the associated issuer; or*
- ii) an issuer of a Listed Security in the same business sector or industry in Malta as the associated issuer; or*
- iii) an issuer of a Listed Security which has a close business relationship with the associated issuer;*

Moreover, the restricted person may only provide any other investment service (such as arranging deals, stockbroking, or dealing as agent) in relation to (i), (ii) or (iii) above, on condition that such services are solely provided on a purely execution only basis on the instructions of a customer (or his independent and authorised adviser) and as long as it can clearly be shown that the customer has been informed of the situation and that the deal is undertaken without any advice being given or any discretion being exercised by the restricted person.

A restricted person shall not discuss with or provide any information relating to the securities or the affairs of:

- i) the associated issuer; or*
- ii) an issuer of a Listed Security in the same business sector or industry in Malta as the associated issuer; or*
- iii) an issuer of a Listed Security which has a close business relationship with the associated issuer;*

² 'Listed Security': any Instrument which is quoted on a Recognised Investment Exchange (IS Guidelines Glossary of Terms)

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to any director, partner or employee of the Licence Holder involved in the provision of investment advice and/ or portfolio management services to clients in relation to Listed Securities.

- b. *Where the Licence Holder is itself an issuer of a Listed Security, it may not provide investment advice and/ or portfolio management services in relation to:*
- i) *its own securities; or*
 - ii) *the securities of an issuer of a Listed Security in the same business sector or industry in Malta as the Licence Holder; or*
 - iii) *the securities of an issuer of a Listed Security which has a close business relationship with the Licence Holder*

unless it has appropriate internal procedures and operational arrangements in place – to the satisfaction of the MFSA – to ensure the proper management of potential conflicts of interests. In considering the adequacy and appropriateness of such internal procedures and operational arrangements, the MFSA will take account of the following:

- i) *the extent of independence between the person/s to be involved in the provision of investment advice and/ or portfolio management services in relation to Listed Securities, including i), (ii) and (iii) above, and the directors of the Licence Holder and employees occupying a position of trust with the Licence Holder having access to 'inside information' (as defined in the Prevention of Financial Market Abuse Act, 2005) regarding the Licence Holder; and*
- ii) *the extent of independence between the Licence Holder's analysts (where available) providing research material to the persons providing investment advice and/ or portfolio management services in relation to Listed Securities including (i), (ii) and (iii) above, and the directors of the Licence Holder and employees occupying a position of trust with the Licence Holder having access to 'inside information' (as defined in the Prevention of Financial Market Abuse Act, 2005) regarding the Licence Holder*

Moreover, before providing investment advice or portfolio management services in relation to:

- i) *the securities of an issuer of a Listed Security in the same business sector or industry in Malta as the Licence Holder; or*
- ii) *the securities of an issuer of a Listed Security which has a close business relationship with the Licence Holder*

the Licence Holder is required to provide written disclosure to customers regarding its status as an issuer of Listed Securities and regarding the connection with the issuer of securities referred to in (i) or (ii) above.

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We look forward to receipt of any comments or representations you would like to make in relation to the above-mentioned proposed changes, which should be submitted in writing by not later than **Wednesday 8th March, 2006**. In the meantime, should you have any queries with respect to this matter, please do not hesitate to contact Mr. Christopher Buttigieg or the undersigned .

Yours faithfully,



Cristina Parlato Trigona

Director

Changes to the ISG 06-02-06